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Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

ANNUAL REPORT 2011

FINMA's MANDATE

As an independent supervisory authority, the Swiss Financial Market Supervisory Authority FINMA protects creditors, investors and policy holders, ensuring the smooth functioning of the financial markets and preserving their reputation. In doing so, it contributes indirectly to enhancing the competitiveness of the financial sector.

In its role as state supervisory authority, FINMA acts as an oversight authority of banks, insurance companies, stock exchanges, securities dealers, collective investment schemes, distributors and insurance intermediaries. It is responsible for combating money laundering and, where necessary, conducts restructuring and bankruptcy proceedings, and issues operating licences for companies in the supervised sectors. Through its supervisory activities, it ensures that supervised institutions comply with the requisite laws, ordinances, directives and regulations, and continue at all times to fulfil the licensing requirements.

FINMA imposes sanctions and provides administrative assistance to the extent permissible by law. It also supervises the disclosure of shareholdings, conducts the necessary proceedings, issues orders and, where wrongdoing is suspected, files criminal complaints with the Swiss Federal Department of Finance (FDF). Moreover, FINMA supervises public takeover bids and, in particular, is the complaints body for appeals against decisions of the Swiss Takeover Board (TOB).

Finally, FINMA also acts as a regulatory body: it participates in legislative procedures, issues its own ordinances and circulars where authorised to do so, and is responsible for the recognition of self-regulatory standards.

FINMA

Annual Report 2011

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CONTENTS

EDITORIAL BY THE CHAIR OF THE BOARD OF DIRECTORS 7

INTERVIEW WITH THE CEO 8

AN OVERVIEW OF FINMA

INTRODUCTION 14
Implementation of the strategic goals at a glance 14
FINMA and parliamentary oversight 16

KEY THEMES 17
Systemically important institutions: more equity capital is essential 17
Swiss Solvency Test: insurers under scrutiny 19
CISA revision: improved protection for investors 21
Developments in cross-border financial services 22

OVERARCHING THEMES 24
The economic environment and financial stability 24
The mortgage market and lending 25
Distribution rules 26
Insolvency regulations for the financial market 27
International cooperation 28
Auditing 30

REGULATION, SUPERVISION AND ENFORCEMENT

BANKS AND SECURITIES DEALERS 34
Overview of banks and securities dealers 34
Changes in banking regulation 36
Supervisory reviews 39
Stress tests 40
Team Intensive Supervision 41

INSURANCE COMPANIES 42
Overview of insurance companies 42
Changes in insurance regulation 47
The second Swiss Qualitative Assessment 48
Group supervision and international developments 49
Recognition of the equivalence of Swiss insurance supervision 50

MARKETS 51
Overview of markets 51
Changes in market regulation 53
Exchange-traded funds 55
Valuation experts of Swiss real estate funds 56
Banks' handling of assets of politically exposed persons 57

ENFORCEMENT 58
Overview of enforcement 58
Enforcement statistics 59
Revision of the Stock Exchange Act: expanding market supervision 60
Enforcement practice 61

FINMA AS AN AUTHORITY

BOARD OF DIRECTORS AND EXECUTIVE BOARD 66
The Board of Directors 66
Committees of the Board of Directors 67
The Executive Board 68
Enforcement Committee 68

STAFF 69
Headcount and structure 69
Organisation chart 70
Human resources strategy 72

OPERATIONAL DEVELOPMENT WITHIN FINMA 74

APPENDIX

FINANCIAL MARKET REGULATION: STATUS AND OUTLOOK 78

STATISTICS 82

MoUs AT THE NATIONAL AND INTERNATIONAL LEVEL 84

FINMA'S REPRESENTATION IN INTERNATIONAL WORKING GROUPS 85

GLOSSARY 86

ABBREVIATIONS 90

Prof. Anne Héritier Lachat,
Chair of the Board of Directors

EDITORIAL BY THE CHAIR OF THE BOARD OF DIRECTORS

The difficulty of measuring the invisible

Compiling an annual report is always something of a balancing act. When we look back at what has been achieved, we tend to be insufficiently objective. When we turn to the future, we are often much too optimistic, a fact that later review sometimes exposes mercilessly.

Financial market supervision cannot be measured in terms of specific, tangible 'products'. It is virtually impossible to quantify objectively all the risks to banks, insurance companies and the markets that have been avoided or reduced by FINMA's intervention, as it is difficult to explain in words events that failed to occur or whose impact has been mitigated. For that reason, it is far from easy to find benchmarks against which FINMA's work in 2011 can be measured sensibly. Perhaps the best approach is to compare the results we actually achieved in 2011 against the objectives we had set ourselves.

Of the strategic goals defined in 2009, improving supervision, minimising the risk emanating from systemically important financial institutions, and strengthening client protection are central. They played a key role in 2011, against the backdrop of continuing crisis and an unstable economic environment – a situation that imposed a considerable workload and demanded great adaptability.

We continued to work tirelessly in the field of supervisory activity, seeking in particular to increase efficiency by acting in a more direct and targeted manner. Yet this is still a work in progress; it includes a major drive to train and develop our staff and to seek out new talent. Supervision is at the core of FINMA's activities and therefore merits our undivided attention.

Reducing systemic risks is a task for the long term. Parliament took an important and welcome step in this direction when it passed new regulations in September 2011. Practical implementation of the associated measures will entail much work for both FINMA and the institutions it supervises in the years ahead.

In FINMA's view, the protection of investors and clients is based on two pillars. Traditionally, the goal has been to maintain the economic health of supervised institutions and ensure that they keep their risks under control through prudential supervision. Yet that alone will not suffice to protect clients effectively against the errors of financial intermediaries or complicated and often highly intransparent products. FINMA has made various efforts in this regard and has repeatedly stressed that the protection afforded to investors in Switzerland is too weak. We will continue working intensively on this topic in 2012.

In the future, we will also face numerous further challenges. I would like to express my gratitude to the entire staff of FINMA for their dedication and hard work in an often difficult environment, and thank the Executive Board and my colleagues on the Board of Directors for their support. The future holds much in store, and it is therefore vital that we continue working together in our common cause.

Prof. Anne Héritier Lachat, Chair
December 2011

INTERVIEW WITH THE CEO

'We must expect the market to consolidate.'

Patrick Raaflaub, you are no doubt concerned about the situation regarding the international financial markets. They are in turmoil, constantly battered by storms and hurricanes. When will normality finally be restored?

I'm wary of making predictions. As a supervisory authority, we need to be ready for all weather conditions. At the moment, the financial markets are having an extremely torrid time. Despite massive intervention by governments and central banks, there has been no sustained improvement in the situation, and the process of debt reduction is progressing only slowly. In some cases, debts have shifted in recent years from the private to the public sector. Now, even national budgets have run into trouble and, with them, the entire financial sector. It is difficult to say when we will break free of this vicious circle.

And what is the Financial Market Supervisory Authority FINMA doing about it?

We need to be prepared for all eventualities. It is part of our remit to think through all the negative scenarios, even down to the worst case. We are stepping up our supervision in those areas that are most at risk, and imposing more stringent requirements on the institutions we supervise.

Nevertheless, the waves in Switzerland are less high than in the rest of Europe.

It's certainly true that Switzerland and its financial sector are relatively stable and less affected than others by the financial crisis. Nevertheless, the Swiss economy is international in outlook and closely tied to the global economy, so we are inevitably affected by developments abroad. If the euro crisis were to become more acute, this would have a major impact on the stability of Switzerland's financial sector. It is vital for us to be on our guard.

So the idea that Switzerland is an island of calm is an illusion?

We are seriously concerned about a number of areas here at home. Interest rates, for example, have never been so low for so long. Interest levels only barely above zero make it very difficult for banks and insurance companies, as well as private and institutional investors, to generate adequate returns. They are also prompting many people in Switzerland to act imprudently and take on excessive levels of debt, for instance in the form of mortgages. It is FINMA's responsibility to act as a moderating influence on the institutions and to intervene where necessary.

One big issue in 2011 was the 'too big to fail' debate. The package made its way through Parliament in record time. Do you see that as a cause for satisfaction?

Parliament acted with exceptional speed and passed the Commission of Experts' proposals into law essentially undiluted. Abroad too, much has been done to adjust to the new circumstances, and I very much welcome that. Here in Switzerland, we must not stand still. We have initiated some important new regulations, but they need to be implemented before they can exert their full effect. We are also far from having resolved all the problems: dealing with systemically important institutions, for example.

So improvements are still needed before – in a worst-case scenario – the two systemically important big banks could be allowed to fail without inflicting serious damage on the Swiss economy as a whole?

Precisely. We still haven't found the optimum solution to this problem. We could potentially learn something from the approach adopted in the UK, which is aiming to impose a stricter separation of retail and investment banking without completely

Dr Patrick Raaflaub, CEO

turning the clock back. The UK is not planning a wholesale return to ring-fencing of banking activities, but rather to unwind the sensitive areas where that is absolutely necessary. I believe that is a reasonable strategy.

International pressure on the cross-border asset management business of many banks has been immense, posing challenges for both institutions and government. Are the changes going in the right direction?

Swiss banks and politicians are now almost entirely committed to a 'white money' strategy which I welcome very much. For decades, Swiss banks exposed themselves to major legal and reputational risks by accepting assets from foreign clients which, in some cases, had not been declared for tax purposes. Now – in times of acute financial austerity in the countries concerned – those actions are having a lasting impact. The banks need to review and replace their old business models quickly. Finding a solution to the problem is of vital importance to the entire Swiss financial sector.

And what is the new business model for banks whose asset management business is crumbling but which at the same time face rising capital requirements?

We must expect the market to consolidate: some banks will disappear, others will have to adapt their business models. In such difficult times, I believe the best approach is for institutions to focus on their strengths and commit themselves systematically to a strategy of quality. This means that Swiss banks must profile themselves as capable advisors to their clients in a very stable country. To do that, they must deliver better services to their clients than their rivals abroad can offer.

In stormy times, it is often investors who lose out. What is FINMA doing to protect them?

It's certainly true that investor protection in Switzerland is not all that it might be. Our laws are relatively underdeveloped by international standards and are in urgent need of improvement. We knew that even before the collapse of Lehman Brothers. But every time anyone takes a step in this direction, they encounter massive resistance from the areas of the financial sector that are affected. The efforts to revise the Collective Investment Schemes Act that began in autumn 2011 are a prime example. The revision of CISA attempts to introduce certain standards for all managers of collective investment schemes that have long been accepted in the financial sector internationally. Although this move was designed merely to bring us up to international standards, it met with widespread opposition in the consultation process.

FINMA has been operating almost permanently in crisis mode since 2009, and the authority's employees are under great pressure. What are you doing to ensure that FINMA's staff can function effectively?

In turbulent times such as these, the work of the supervisory authority is both exciting and exceptionally demanding. On the one hand, it faces criticism from supervised institutions that do not appreciate its questions or supervisory measures. On the other, it has its statutory remit and is also under pressure from the public at large, who expect FINMA to notice every significant slip-up by the supervised institutions and take prompt action to address it. That is a difficult environment in which to operate, and I have great respect for the way in which FINMA's staff rise to the challenge. I am personally committed to ensuring that we provide even greater support to our staff in future.

Editor's note:
The interview with Dr Patrick Raaflaub took place in December 2011.

AN OVERVIEW OF FINMA

INTRODUCTION

Implementation of the strategic goals at a glance

The financial market legislation clearly delineates FINMA's area of activity. It grants FINMA a degree of flexibility that it has formulated in seven strategic goals. FINMA made progress in 2011, notably in areas such as the 'too big to fail' issue and the further development of its supervisory activities.

Strategy implementation in 2011

Reducing systemic risks

- Key player in the drafting of the 'too big to fail' package of measures
- Significantly enhanced activities in connection with the early identification and containment of systemic risks (examples: debt crisis, real estate market)
- Assistance in drafting new capital adequacy requirements for banks in respect of mortgage claims

Improving client protection

- Action taken to enhance client protection as part of the CISA revision
- Full introduction of the Swiss Solvency Test (SST) as the main tool for effective client protection in the insurance sector
- Evaluation of the consultation on the FINMA Distribution Report 2010

Streamlining and optimising regulation

- Drafting the revision proposals for national implementation of the new Basel III standards as part of a national working group
- Issuing the FINMA Circular 'Capital adequacy and capital planning – banks' to improve the crisis resistance of smaller banks
- Amendment to the FINMA Circular 'Rating agencies' setting out new, standardised FINMA requirements concerning the use of credit ratings under supervisory law for all areas of supervision

Effective and efficient supervision

- Implementation of measures to ensure that supervisory activity is more systematically risk-oriented
- Closer, more frequent and more direct supervision of institutions in higher risk categories
- Cross-sector harmonisation of approach to licensing and supervision

At least once a year, FINMA discusses its strategic goals and current issues relating to financial market policy with the Swiss Federal Council. At the meeting held in 2011, the Chair of FINMA presented the important results that FINMA had achieved or was close to achieving in the implementation of its strategic goals as well as those that still require further action. In doing so, the Chair focused on FINMA's supervisory activities which form its core competence. The Federal Council recognised and endorsed the work carried out by FINMA.

Sustainable market supervision and effective enforcement

- Restructuring of enforcement processes and organisation to enable uniform, efficient enforcement activity
- Adjustments in practice concerning the handling of violations of reporting obligations in connection with the disclosure of shareholdings
- Exceptional audit of the handling of PEP relationships by banks

Positioning for international stability

- Substantial progress towards obtaining recognition of Swiss insurance supervision as equivalent to the EU Solvency II Directive
- Raising awareness of how to deal with risks arising from the cross-border financial services business, accompanied by numerous on-site inspections
- Continuing important working relationships with the FSB, BCBS and IAIS to play a role in shaping international standards

Strengthening FINMA as an authority

- Further refinement of operating structures and their alignment with the strategic goals
- Development of the specialist career model as an alternative to the management career

Implementation of the strategic goals is not yet complete. In 2012, FINMA aims to achieve significant progress, chiefly in the following areas:

- further elaboration of the 'too big to fail' measures, partly at ordinance level and partly as taken by the banks themselves;
- implementation of the Basel III standards;
- distribution of financial products;
- supervision of managers of collective investment schemes;
- implementation of the SST;
- operational implementation of the enforcement approach;
- ensuring that supervised institutions measure up to FINMA's expectations in respect of the legal risks arising from the cross-border financial services business.

FINMA and parliamentary oversight

Supervision of the financial markets is conducted independently of Parliament and government. Nevertheless, FINMA is integrated into the structures of the Swiss state and is therefore subject to parliamentary oversight. Ultimately, therefore, it is accountable to Parliament.

Each year, after FINMA's annual report has been approved by the Federal Council, FINMA meets with the Control Committees of the Federal Assembly (CC) to discuss the report, the financial statements and the main focus of its supervisory activities.

Disclosure obligations, politically exposed persons and supervisory activities

In 2011, the annual meeting with the CC took place at the end of April, and also provided an opportunity to discuss a range of other issues. In advance of the meeting, the CC had posed a series of questions on the handling of the disclosure obligation under Article 20 SESTA and requested FINMA to prepare a report. There was also a discussion of FINMA's monitoring of due diligence obligations under the anti-money laundering regulations, focusing on this occasion on the assets of politically exposed persons (PEPs).[1]

In its comments on the CC investigation into the conduct of the authorities in the financial crisis of 2008, FINMA indicated its intention to produce a report on its supervisory instruments, working processes and organisation. FINMA's report on effectiveness and efficiency in supervision[2] explained its new, risk-oriented supervisory approach to the CC, the Federal Council and, finally, the public at large. In the conclusion to its investigation of the financial crisis, published in July 2011, the CC conceded that 'the approach adopted in the measures outlined in FINMA's report meets the requirements of recommendations 3 and 6, and indicates that FINMA is adjusting to developments in the financial system. However, the CC will not make a definitive statement on the implementation of its two recommendations until the work of the external experts is complete and the Federal Council has submitted its comments.' This will occur in 2012.

In the fourth quarter of 2011, the Control Committee of the Council of States (CC-S) also approached FINMA with questions regarding the latter's investigation of the sale of Lehman products by Credit Suisse. The FDF/FDEA Subcommittee of the CC-S had set a deadline of January 2012 for answers to those questions, which FINMA will duly provide.

'Too big to fail' the main topic of expert information

FINMA was required to respond to numerous parliamentary procedural requests related to the 'too big to fail' issue. It also played a central role in the 'too big to fail' regulatory project and provided expert information to sessions of parliamentary committees, for instance in the Committees for Economic Affairs and Taxation (CEAT).

[1] See section on 'Banks' handling of assets of politically exposed persons', p. 57.
[2] See http://www.finma.ch/e/finma/publikationen/Documents/br-aufsicht-20110421-e.pdf.

KEY THEMES

Systemically important institutions: more equity capital is essential

FINMA assists in the framing of international regulatory and supervisory standards and promotes their implementation at the national level. The importance of this task is lent extra weight by the importance of Switzerland's two big banks not only to the Swiss economy but also to the stability of the global financial system.

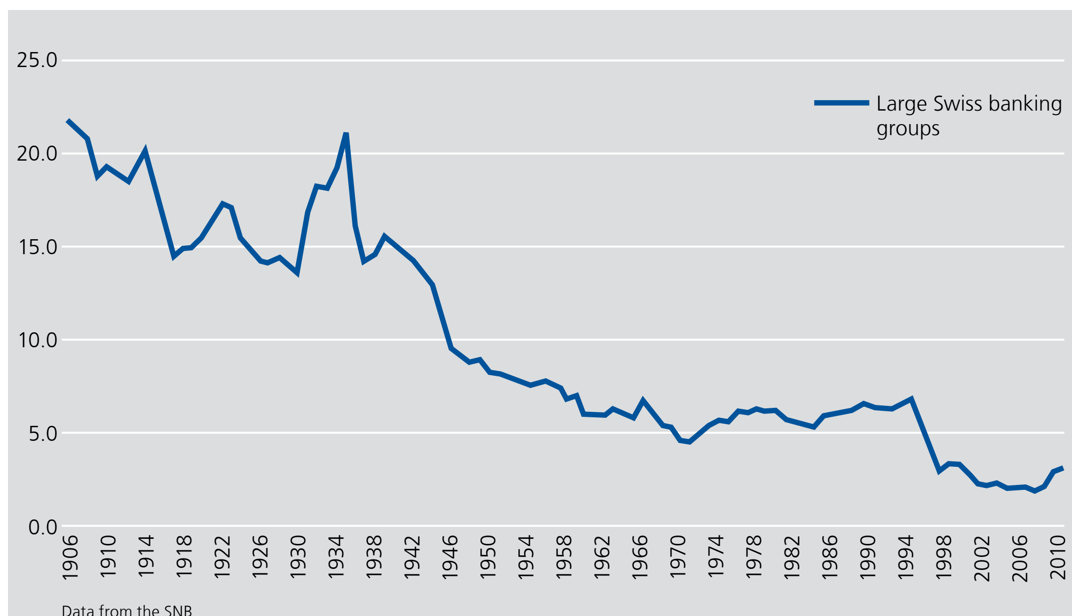
In October 2010, the Commission of Experts for limiting the economic risks posed by large companies[3] adopted a proposal on limiting the risks to the Swiss economy from systemically important financial institutions. The Federal Department of Finance FDF, FINMA and the Swiss National Bank (SNB) then began work on incorporating the proposals into the relevant legislation. On 30 September 2011, Parliament approved the necessary legislative amendments to the Banking Act. At the level of implementing legislation (Banking Ordinance and Capital Adequacy Ordinance), a consultation was opened on 5 December 2011.

Capital and liquidity requirements increased

Looking back, it is clear that the capital ratio – measured against banks' total assets – has fallen sharply over the last 100 years. Since the early 1990s, the balance sheet equity capital ratio declined to a level that has proved unsustainable following the financial crisis of 2008 (see chart below).

Basel III and the Swiss 'too big to fail' regulations halted the trend towards ever-lower capital underpinning by introducing increased capital and liquidity requirements. Along with these regulations, the adapted Banking Act also requires systemically important banks to respond to crises at an early stage and prepare the restructuring and resolution of the bank group by implementing emergency plans to continue its systemically important functions. The capital adequacy rules for systemically important institutions also complement the minimum capital requirements under the Basel III framework of the Basel Committee on Banking Supervision (BCBS). As is also the case for non-systemically important banks, it is prescribed that the basic component

Change in capital ratios measured against total assets in Switzerland



[3] See FINMA Annual Report 2010, p. 11, or http://www.sif.admin.ch/index.html?lang=en: Documentation – Reports – 'Too big to fail' commission of experts.

amounts to 4.5% of risk-weighted assets and is to be filled with Common Equity Tier 1 (CET1). The loss-bearing capacity of systemically important banks is to be increased by means of a capital buffer amounting to 8.5% of risk-weighted assets and a progressive component, which, depending on the market share and size, can amount to up to 6% of risk-weighted assets. Through reductions on the progressive component, an incentive is created for banks to improve their resolvability. Along with the eligibile capital in the buffer and the progressive component, Swiss regulation also provides for a loss-absorbing effect in the form of convertible capital. The new capital standards for systemically important banks are summarised in the table on page 37 and are compared to those of Basel III as well as to the BCBS and Financial Stability Board (FSB) rules for global systemically important financial institutions.

Switzerland's big banks and the stability of the global financial system

Switzerland's two big banks are systemically important not only to the Swiss economy, but also to the stability of the global financial system, and are therefore regarded as global systemically important banks (G-SIBs). For this reason, Swiss initiatives to regulate systemically important banks have an international dimension. As a member of the BCBS and the Financial Stability Board (FSB), FINMA is actively involved in formulating the rules for determining an additional capital requirement for G-SIBs, which, in conceptual terms, corresponds to the progressive component in the Swiss regulation. This is equal to up to 2.5% of risk-weighted assets, depending on systemic importance. FINMA also contributes to international discussions on improving and enhancing the supervision of G-SIBs and works to implement the resulting conclusions in its supervisory activities.

Systemic risks extend to other sectors

Questions of systemic importance and appropriate measures are not confined to the banking sector, but may also arise in connection with insurance companies, groups, conglomerates and other market participants. They are addressed both by the FSB as the international standard-setter and by national bodies. Responses to those questions are not focused on the conventional insurance business, since no actual trend towards the creation of systemically important risks has so far been detected in this area. Extensive links of insurers to other areas of the financial market, however, mean that exposure to the systemic risks in those areas is inevitable. If an insurer is involved in what is termed non-traditional insurance business[4] and in business outside the insurance sector,[5] it may lay itself open to the same risks as systemically important banks. FINMA represents this position in the international arena, notably on the Financial Stability Committee (FSC) of the International Association of Insurance Supervisors (IAIS) and the FSB. The FSC is currently developing a methodology for identifying global systemically important insurers (G-SIIs) and preparing appropriate measures. A methodology is expected to be submitted to the FSB ahead of the G-20 summit in June 2012. Identification of G-SIIs among insurance companies will follow at a later date.

[4] For example, in connection with fund-linked life insurance with maturity guarantees (so-called variable annuities).
[5] When insurance companies are involved in banking or capital market transactions.

Swiss Solvency Test: insurers under scrutiny

Following a five-year transitional period, the Swiss Solvency Test (SST) became mandatory in all respects on 1 January 2011. Around half of the insurers subject to the SST opted for internal risk models to determine their solvency requirements. FINMA is currently hard at work assessing those models.

The introduction of the SST[6] represented a major challenge for many of those affected. During the introductory phase which began in 2006, the financial crisis of 2008 and the subsequent period of low interest rates had a particularly negative effect on the balance sheets of life insurers, hindering many companies' efforts to accumulate sufficient capital by 1 January 2011. FINMA initiated measures at a number of companies to strengthen their capital base and thereby effected a sustained improvement in their solvency situation.

Auditing internal models

Insurance companies and groups are obliged to satisfy the requirements of the SST. They can base their SST reporting either on a standard model or on wholly or partly internal risk models, which must comply with FINMA requirements. In certain cases, the complexity of the risk structure renders the use of internal models mandatory. Approximately 70 companies – roughly half of all insurers subject to the SST – have submitted applications to use an internal model. In an initial phase, FINMA completed an assessment of around 15 smaller and medium-sized insurance companies and informed them of its decision. It then proceeded to examine the models of those companies whose solvency requires particular attention. FINMA is currently assessing the models of the large listed insurance groups, with a view to preventing market distortions. The first authorisation for a large group was granted at the end of 2011. During the year, FINMA reviewed almost 30 models and delivered its verdict. Around two thirds of the models assessed were approved, in some cases subject to special conditions; the remainder were sent back to the institution concerned to be revised. The target is to reach a decision on the majority of the 70 insurance companies and groups by the end of 2012. In cases where assessment of the internal model is not yet complete but where it contains no obvious weaknesses, FINMA will grant provisional approval so that the 2011 and 2012 SST calculations can be carried out.

Stress tests in the insurance sector

A key component of the SST is what are termed scenario analyses. In addition to the scenarios stipulated by FINMA, each insurance company must define scenarios of its own that take account of its individual risk situation. As with banks, scenario analyses are a valuable instrument in the supervision of insurance companies. The results must be discussed as part of the risk management process and disclosed in SST reporting to FINMA. In particular, insurance companies are expected to assess whether and to what extent the model used to quantify risks underestimates the probability of extreme events. If it does, the scenario results are taken into account when determining the capital requirements. Switzerland's major insurance groups also participate regularly and on a voluntary basis in the stress tests coordinated by the European Insurance and Occupational Pensions Authority (EIOPA).

Solvency II in the EU and EEA

Moves to implement risk-based solvency requirements in the EU and EEA are still ongoing. The corresponding EU Solvency II Directive was adopted in 2009, and the implementing measures[7] are currently being drafted. The indications are that the capital requirements under Solvency II will not become binding until January 2014. Only once the

[6] See Glossary, p. 89.
[7] Level 2 implementing measures.

preparations are complete will it become clear how far the capital requirements of Switzerland's SST and Europe's Solvency II differ, and whether measures will be needed to bring them into alignment. One of the key issues will be the valuation of liabilities arising from life-insurance contracts. Two points are of central importance here: the discount rate to be applied to future payments from life-insurance contracts, and the period over which insurance companies can offset future profits. As regards discount and interest rates, the SST continues to use the yields on Confederation bonds as its benchmark. High demand for security in the wake of the financial crisis has depressed the yields on these instruments to historically low levels. Issuance of long-dated Confederation bonds is also at a very low level. For 2011, FINMA therefore decided to fix the long-term interest rates employed in the SST for valuation purposes using a process that is less sensitive to supply and demand effects and therefore has a stabilising influence.

CISA revision: improved protection for investors

In summer 2011, the Federal Council opened the consultation process on a partial revision of the Swiss Federal Act on Collective Investment Schemes (CISA). The Act, which covers the administration, safekeeping and distribution of collective investment schemes, is to be adjusted to international standards, offering better protection for investors and enhancing the competitiveness of Swiss financial services providers.

In Switzerland, the administration, safekeeping and distribution of collective investment schemes are governed by the Collective Investment Schemes Act, which came into force in its current form on 1 January 2007. This completely revised text, which was specifically aimed at increasing the attractiveness and competitiveness of the Swiss funds sector, did not set out to bring collective investment schemes legislation fully into line with international standards.

Stricter international regulation

A number of international regulatory projects have been launched, not least in response to the experience gained during the crisis. These also led to more stringent requirements in connection with collective investment schemes. Through the Dodd–Frank Wall Street Reform and Consumer Protection Act, the US introduced a registration requirement for certain managers of collective investment schemes that had not previously been subject to supervision. Under the AIFM Directive (AIFMD) adopted on 11 November 2010, the EU likewise subjects managers of non-UCITS[8] to compulsory supervision.

As a result of these international developments, the gaps in the legislation of Swiss collective investment schemes may lead to a significant deterioration in the protection of Swiss investors. For example, as the law now stands Switzerland will be the only European jurisdiction that continues to permit non-regulated market participants which do not satisfy the requirements of the new AIFMD to distribute their products to qualified investors without meeting regulatory and supervisory requirements. It is also likely that foreign market participants wishing to avoid regulation will increasingly move their activities to Switzerland. Furthermore, if Swiss regulations are not compliant with international standards, Swiss financial services providers will find it more difficult or even impossible to access the EU market from 2013 onwards.

Closing gaps in the legislation of Swiss collective investment schemes

With a view to improving investor protection and enhancing the quality and competitiveness of Swiss financial services providers, the Federal Council decided to embark on an urgent revision of the Collective Investment Schemes Act. The consultation on a partial revision of the Act closed at the beginning of October 2011. In its comments, FINMA welcomed the changes proposed by the Federal Council, but emphasised that they do not go far enough. It noted that the experience of recent years has highlighted a need for action not only in administration, safekeeping and distribution, but also in the areas of fee and cost transparency, the requirements for paying agents and representatives of foreign collective investment schemes, and structured products.

[8] See Glossary, p. 87.

Developments in cross-border financial services

The legal and reputational risks involved in cross-border financial services are becoming increasingly apparent. In 2011, FINMA dealt with investigations carried out by a number of US authorities into Swiss banks. Following publication of its position paper on legal and reputational risks in cross-border financial services in October 2010, FINMA reviewed the implementation of the expectations voiced in that paper and initiated targeted enforcement proceedings.

In October 2010, FINMA published a position paper[9] setting out its assessment of the legal and reputational risks involved in cross-border financial services. The paper formulates the authority's expectations concerning the supervised institutions active in this area, based on the requirements stipulated in the financial market legislation concerning appropriate organisational structure and risk management and the assurance of proper business conduct. These requirements also apply to the cross-border business. In 2011, the process of implementing the expectations set out in the position paper began at various levels. As well as supervisory consultations, FINMA staff or audit firms carried out direct, on-site checks of supervised institutions. In some cases, FINMA instructed institutions to carry out internal investigations that must satisfy particular requirements in terms of governance and scope. Where there was evidence of serious breaches of supervisory law, enforcement proceedings were initiated with a view to establishing whether the institution's conduct of its cross-border business exposed it to legal and reputational risks that are incompatible with the regulatory and supervisory requirements governing its licence. FINMA expects supervised institutions that provide cross-border services to verify at regular intervals the supervisory requirements under foreign law, as well as other relevant provisions. The associated risks must be captured, limited and controlled, and minimised through the implementation of appropriate measures, in particular guidelines on business operations permitted in the target countries. Suitable training must be provided for staff. Remuneration schemes must be structured in such a way as to promote and not penalise proper compliance. Compliance with such guidelines must be monitored appropriately. If necessary, institutions must adapt their business models and refrain from engaging in business in certain markets.

Negotiations between Switzerland and the US

In 2011, various US authorities conducted investigations into Swiss banks involved in cross-border business with US clients. These focused on accusations of breaches of US supervisory law and criminally assisting tax offences against the US tax authorities. The US objected in particular to the practice of accepting US clients who, from mid-2008 onwards, were required to terminate their business relationships with UBS.

As a result, more than a dozen prosecutions were launched against bank staff or third-party providers. FINMA instructed the institutions that were subject to criminal investigations to address the associated risks. It assessed the institutions' conduct from a supervisory perspective. The focus was not on breaches of foreign rules – enforcement of which is not FINMA's responsibility – but on the issue of shortcomings in risk management and an institution's organisation from a regulatory and supervisory perspective.

The crucial point is that, except in specific circumstances, the acceptance and management of undeclared assets of foreign clients has been permitted under Swiss law for decades, and in particular does not constitute a criminal offence. This situation did not change when OECD Standard 26 was adopted in March 2009. Under the amended

[9] See http://www.finma.ch/e/finma/publikationen/Documents/positionspapier_rechtsrisiken_e.pdf.

double taxation agreements, Switzerland can now provide administrative assistance to foreign tax authorities in cases of tax evasion and for pure tax assessment purposes. As a result, more information on aiding and abetting criminal offences is also passed to foreign authorities. Aiding and abetting in the commission of a crime is itself often a criminal offence under foreign law. This further increases the risks for those involved, risks that are based on foreign and not on Swiss legislation.

The negotiations on tax matters between Switzerland and the US are being conducted by the State Secretariat for International Financial Matters SIF. FINMA provides assistance focused on its core legislative remit.

Foreign Account Tax Compliance Act

The US Foreign Account Tax Compliance Act (FATCA), which comes into force on 1 January 2013, introduces a new approach to dealing with US persons who maintain business relationships abroad. FATCA has far-reaching implications, not only for US persons (clients) but also for US and non-US financial institutions. The main emphasis is on those financial intermediaries whose area of business is considered to involve a high potential for tax evasion. FINMA is not mandated to enforce foreign law, but it does expect supervised institutions to establish whether they fall within the scope of FATCA and to assess their strategic options.

UBS client data: Federal Supreme Court backs FINMA's decision

On 18 February 2009, based on Article 26 of the Banking Act (BA), FINMA ordered the release of a clearly limited number of UBS client data to the US authorities in order to forestall the threat of criminal proceedings by the US authorities and avert an acute risk to the bank's liquidity and stability. On 5 January 2010, the Federal Administrative Court declared the transfer of bank client data to be illegal.

On 15 July 2011, however, the Federal Supreme Court as court of final appeal came to a different decision. It partially upheld FINMA's appeal against the judgement of the Federal Administrative Court. While acknowledging that FINMA's action was not supported by Article 26 BA, it held that the authority was entitled to act on the basis of the general police powers clause. The danger to the economic stability and functioning of the financial market was acute. Additionally, the Federal Council had called on FINMA to take all necessary measures to prevent legal proceedings being initiated against UBS.

OVERARCHING THEMES

The economic environment and financial stability

As a result of the sovereign debt crisis, the economic environment remains difficult. Despite the measures already taken and others that are planned, the stability of the financial markets continues to be threatened and markets are volatile. The earnings prospects of certain financial institutions are weak. FINMA is stepping up its monitoring activities.

Several economies face sharply increased levels of public debt as a consequence of the tax and rescue packages adopted to deal with the financial and economic crisis; some face a serious sovereign debt crisis. Despite expansive monetary policies and low interest rates, growth in many economies remains very weak. There is no global consensus on whether fiscal stimulus or austerity measures are the correct response. Economic imbalances and the resulting risks are causing persistent currency turbulence. Due to its global ties, the Swiss franc and, with it, the Swiss economy are particularly affected.

Challenges to economic growth

There is major global uncertainty concerning the solvency of certain countries and the stability of some institutions. In this difficult environment, the markets' reaction is volatile, with heavy losses and a flight towards what are assumed to be safer assets. This could have a negative impact on the real economy. Many industrialised countries are revealing structural weaknesses that impede economic growth. Persistent budget deficits, high levels of government and, in some cases, private debt, social systems in need of reform and labour markets present major challenges for national economies. At the same time, implementing appropriate measures is proving politically difficult. After years of strong expansion, the emerging nations are expected to experience a cooling of economic growth. Nevertheless, the centre of financial and economic activity will continue to shift towards these countries.

Challenges for financial institutions

Uncertainty and the risks in the markets are reflected in institutions' forecasts of declining business and earnings. Switzerland's large banking groups have initiated large-scale cost-cutting measures. Further restructuring of national debts would impose additional burdens not only on the financial sector but also on private investors. An economic downturn in Europe and other regions can also be expected to weigh on the Swiss economy. The economic and inflation forecasts issued by central and issuing banks continue to point to historically low interest rates going forward. This may impact the earnings of banks and insurance companies. Equally, however, an abrupt and lasting change in interest rates could pose a serious threat to financial market stability.

Challenges for FINMA

FINMA has stepped up its supervisory activities in response to the euro crisis. In particular, it has intensified its monitoring of the risks affecting banks and insurance companies, especially their liquidity and capital planning, and their exposure to the so-called GIIPS states. Supervised institutions are being required to report regularly on the extent of their links to other such institutions (including within their own group), their total exposure and significant individual positions. One important objective is to identify concentrations of risk and the potential for contagion at an early stage, in case the euro crisis worsens. Where necessary, FINMA is ordering supervised institutions to implement countermeasures.

The mortgage market and lending

For some time now, FINMA has been closely monitoring developments in the domestic residential property market and its financing through mortgages, and is concerned by what it sees. Throughout Switzerland, prices in the residential segment have risen markedly, with a trend towards overheating in some regions.

There is agreement on two developments: property prices are rising, and mortgage portfolios are growing. Domestic mortgage claims have risen since 2009, with annual growth rates of over 4.5%. Opinions differ, however, as to the implications of these developments. Banks involved in the mortgage business believe the price trend is set to continue, and point to high levels of immigration. It is noteworthy, however, that market participants themselves have for some time been warning of overheating in certain regions.

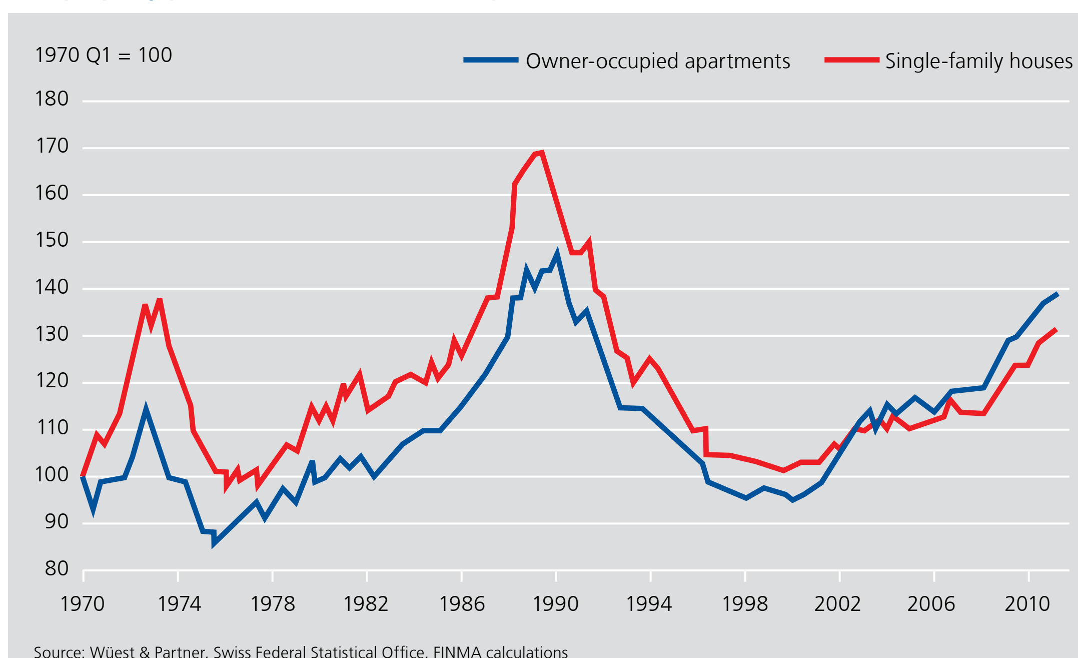
New qualitative guidelines in force

Since the second half of 2010, FINMA has been looking for ways to counteract excessive growth in mortgage exposure, and specifically the relaxation of lending standards and the associated risk management. Initially, FINMA focused on a revision of the self-regulatory mechanisms of the Swiss Bankers Association (SBA). In September 2011, FINMA approved the new guidelines on examining, evaluating and settling mortgage-backed loans as a code of conduct. These stipulate qualitative criteria for mortgage lending in key areas such as financial sustainability, loan-to-value ratios and handling exceptions to policy. FINMA regards the revision as a step in the right direction and an improvement in self-regulation.

New quantitative measures required

Against the backdrop of the steady increase in risks in the mortgage business accentuated by the low interest rates, FINMA nevertheless deems further quantitative measures essential to prevent the

Real property prices in Switzerland – offer price indices



Source: Wüest & Partner, Swiss Federal Statistical Office, FINMA calculations

granting of high-risk loans for financing residential properties. It therefore supports the Federal Council's proposal to tighten capital adequacy requirements for all residential properties to a level beyond current market practice in terms of loan-to-value ratio and financial sustainability. Simultaneously, the capital adequacy requirements for banks, which are currently based on internal models, are to be amended by introducing minimum levels. These measures aim to arrest both the erosion of credit quality and the acceptance of higher risks as a way of generating growth. FINMA believes the measures proposed by the Federal Council are appropriate, independently of the current macroeconomic environment. Further macroprudential measures of a temporary nature may be required to prevent wayward developments of the kind that the persistent low-interest environment encourages.

Distribution rules

Current law does not adequately protect the interests of clients purchasing and selling financial products. FINMA plans to publish a position paper highlighting ways in which private clients in particular can be better protected.

At the end of 2010, FINMA launched the discussion on better protection for clients in the form of a consultation on its Distribution Report.[10] It received numerous comments from interest groups and professional associations within the sector, supervised institutions, consumer associations, authorities and ombudsmen. The report and its comprehensive presentation received a broad, positive reception.

Aligning Swiss rules with international requirements

Among the options outlined, a large proportion of stakeholders approved an expansion of product rules and codes of conduct on the basis of a product-neutral client segmentation. Many respondents to the consultation were in favour of standardising prospectus requirements and of FINMA's proposal of a product description for compound financial products. With regard to the expansion of codes of conduct, the proposal for suitability or appropriateness tests to give force to the various performance obligations and enhanced transparency regarding services and costs were particularly welcomed. It was stressed that the emphasis of future regulation should be on harmonisation with the global and European environments, and in particular the revision of the Markets in Financial Instruments Directive (MiFID).

Respondents also commented on FINMA's proposal to introduce coherent regulation of the distribution of financial products in Switzerland from abroad, with a number agreeing that such regulation was needed to protect clients. Many participants also mentioned considerations of client protection, equal competition and market access as reasons for welcoming a licensing requirement and permanent prudential supervision of external asset managers.

Options rejected

While the creation of a compulsory ombudsman met with approval, most of those expressing an opinion were sceptical of, or opposed to, giving the ombudsman powers to rule on disputes. Finally, there was widespread disapproval of the civil lawsuit options outlined in the paper and the possibility of running training programmes for clients, which was also rejected by FINMA.

Once its evaluation of the consultation is complete, FINMA will announce which measures it considers appropriate to remedy the shortcomings in client protection and will submit corresponding proposals to the political authorities.

[10] See FINMA Annual Report 2010, p. 24 ff.

Insolvency regulations for the financial market

The financial crisis of 2008 clearly demonstrated the need for improvements in insolvency legislation. This led to a partial revision of the restructuring and bankruptcy law for banks, insurance companies and collective investment schemes.

The financial crisis revealed both deficiencies in the business activities of banks and gaps in the legal apparatus. The lack of effective instruments and procedures compelled the Swiss government, like others, to take action to support financial market participants in the interests of the Swiss economy. Legislative amendments were required to prevent a repetition of this situation. On 18 March 2011, Parliament approved a new depositor protection framework, which came into force on 1 September 2011 as part of the Banking Act. The new provisions revise the law on depositor protection and introduce new rules affecting parts of the restructuring and bankruptcy law for banks, insurance companies and collective investment schemes.

Banks: standardised insolvency regulations

While the partial revision of the bankruptcy law aims chiefly to speed up proceedings, restructuring law has been completely redesigned by:

- speeding up proceedings in this area as well;
- allowing restructuring proceedings so as to ensure the continuation of certain (systemically important) functions by transferring these functions to other legal entities or a bridge bank; and
- providing for compulsory corporate actions (in particular the conversion of debt capital into equity capital).

Because the legislation is principles-based, implementing regulations will be required, notably in respect of procedural provisions. FINMA is empowered to act in this area.[11] It commissioned a working group to come up with draft implementing provisions (FINMA Bank Insolvency Ordinance). The draft aims to provide transparency and legal certainty without excessively limiting the authority's freedom of manoeuvre. The ordinance also takes account of relevant international developments.

To exploit synergies and ensure that regulations are internally consistent, the working group decided to merge the existing FINMA Bank Bankruptcy Ordinance with the provisions on restructuring, and in this way to draft a complete set of regulations on bank insolvency. The FINMA Bank Insolvency Ordinance will consist of a general part and two separate parts covering restructuring and bankruptcy, respectively. Specific areas of bank restructuring and bankruptcy law are to be revised once again as part of the 'too big to fail' proposal.[12]

Insurance companies and CISA licence holders

The depositor protection framework also incorporates a partial revision of the Insurance Supervision Act and the Collective Investment Schemes Act in the area of bankruptcy law. FINMA now has sole responsibility for initiating and conducting bankruptcy proceedings against insurance companies and certain licence holders under the Collective Investment Schemes Act. The authority is currently assessing whether implementing provisions will need to be enacted. When drafting these provisions, particular attention will be focused on the specific features of the various types of insurance companies and collective investment schemes relevant to the issues of protecting policy holders and investors, to speeding up proceedings and to ensuring international compatibility.

[11] Art. 28 para. 2 BA.
[12] BBl 2011, 4717.

International cooperation

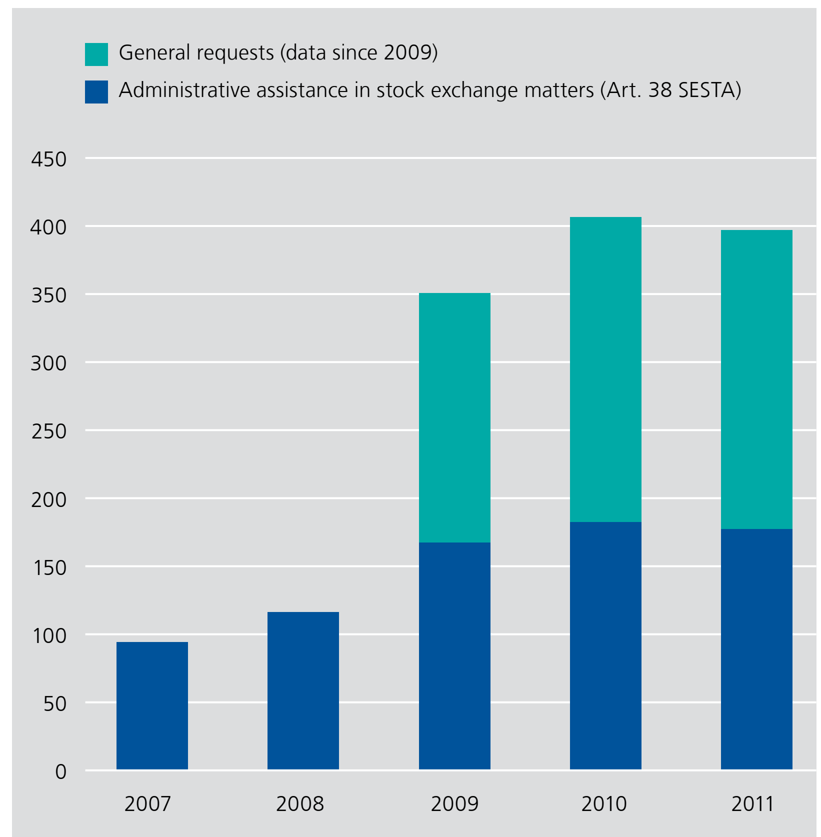
The globalisation of the financial markets accentuates the importance of international cooperation. FINMA's goal is to reconcile more stringent international requirements with Switzerland's relatively restrictive legal framework.

As in previous years, 2011 saw a substantial increase in international cooperation between financial market supervisory authorities. The impact of this has been especially strongly felt by FINMA, as it is one of the three most important points of contact for foreign authorities.

Requests for administrative assistance in cases of insider dealing and price manipulation

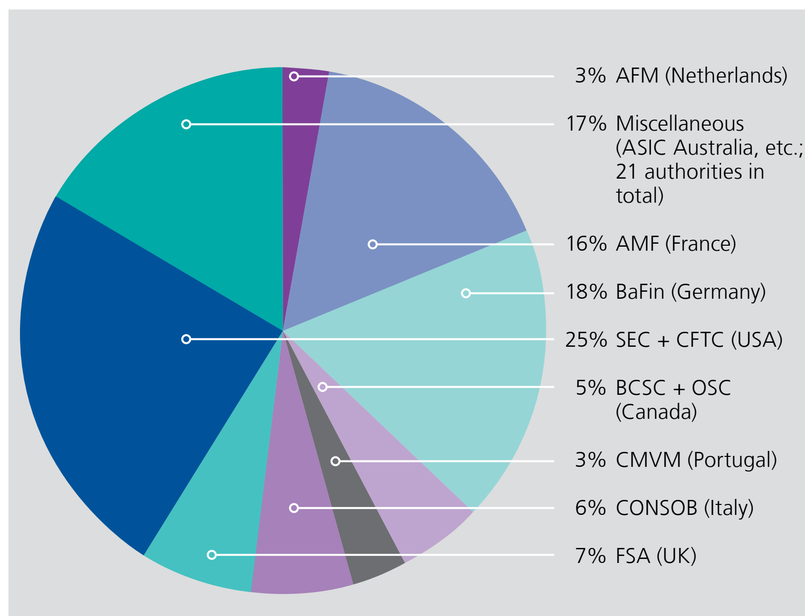
A large proportion of requests for administrative assistance form part of foreign investigations linked to market supervision, for instance in relation to insider dealing, price manipulation, disclosure of shareholdings and unauthorised soliciting of investors. However, cooperation between authorities is also extending further to all other issues related to the cross-border activities of financial intermediaries. Numerous additional questions were asked on issues such as the applicable regulations, the requirement to be supervised, the scope of licences, consolidated supervision and financial stability.

Administrative assistance 2007–2011



In 2011, FINMA received a total of 396 applications from 80 foreign supervisory authorities. Of these, 175 related to possible cases of market abuse.

Requests for administrative assistance in stock exchange matters by authority



The number of requests for administrative assistance is rising. Nowadays, every international financial forum without exception is concerned mainly with the issue of global cooperation. Not only do risks need to be managed at the global level, but it is also essential for supervisory authorities to coordinate their activities and engage in regular, intensive exchange, for instance on running supervisory colleges or joint investigations of supervised institutions.

Administrative assistance – a requirement for market access

International cooperation is crucial to maintaining market access for Swiss financial services providers. Future European rules on the management of alternative investment funds by financial intermediaries from third countries explicitly envisage cooperation agreements between supervisory authorities. The same requirement also forms part of the protocol on the agreement between the Swiss Confederation and the Federal Republic of Germany on cooperation in the areas of tax and the financial market.[13] FINMA can only conclude such agreements if it has appropriate powers and the necessary competencies in relation to information exchange. Looking to the future, it will be vital to reconcile growing international cooperation with Switzerland's still highly restrictive legal framework, since failure to do so will impede the cross-border business of Swiss financial intermediaries.

Conversely, the steadily increasing international fragmentation of exchange trading in Swiss securities is making FINMA increasingly dependent on information from foreign supervisory authorities when carrying out its stock exchange investigations and, especially in market supervision. Where the latter is concerned, the main issue is identifying the beneficial owners behind suspicious securities transactions. In 2011, 14 requests for administrative assistance in such cases were addressed to foreign authorities (four to Germany's BaFin, four to the British FSA, two to the FMA in Liechtenstein and four to other authorities). A further five requests for administrative assistance were submitted to foreign supervisory authorities in connection with disclosure law.

[13] See http://www.sif.admin.ch/00488/index.html?lang=en&msg-id=41313 and http://www.news.admin.ch/NSBSubscriber/message/attachments/24360.pdf (the latter in German only).

Auditing

FINMA's new supervisory approach and the lessons from the financial crisis necessitate improvements in auditing: in future, audit firms must operate more effectively, economically and uniformly, carrying out their activities consistently in the service of FINMA.

FINMA's new risk-oriented supervisory approach defines the interaction between direct supervision by FINMA and indirect supervision using audit firms. FINMA remains committed to the use of audit firms for supervisory tasks, but will expect them to act more efficiently, economically, uniformly and consistently when conducting regulatory and supervisory monitoring activities.

The following specific improvements to auditing are envisaged:

– Regulatory audits under financial market legislation and financial audits required by the Swiss Code of Obligations are to be separated conceptually, due to their fundamental differences and the resulting conflicts of objective.
– FINMA may issue additional audit mandates targeting specific institutions and/or responding to specific events. Basic audits will be reduced in scope and frequency.
– At large institutions the use of two audit teams, each with a lead auditor, and the assignment of separate personnel will in future be the norm. At other institutions, depending on their complexity and risk situation, the function of the lead auditor can be performed by the same person in both the financial audit and the regulatory audit, provided the institution's situation permits this.
– The usefulness of the regulatory audit is to be enhanced while maintaining or even reducing the costs for supervised institutions. To achieve this, the risk-oriented regulatory audit will, for example, be targeted at the institution's core business as well as at its innovations or special cases.

REGULATION, SUPERVISION AND ENFORCEMENT

BANKS AND SECURITIES DEALERS

Overview of banks and securities dealers

2011 saw a further increase in the risks and challenges facing the banking sector. FINMA is adopting a range of measures to enhance the sector's robustness, but expects a degree of consolidation and has taken steps to respond to this.

Retail banks face both financial and organisational challenges to their core business due to the exceptional interest-rate situation. Reduced earnings resulting from record-low interest rates on loans are being partially compensated for through higher volumes, greater interest-rate risks or more relaxed lending rules. The deteriorating economic environment also puts pressure on the credit quality of loans.

Tense situation in the credit sector

FINMA expects a further rise in the probability of default, not only on mortgages, but also on commercial loans. Particularly close attention is being paid to the mortgage market, where FINMA is systematically carrying out stress tests and supervisory reviews. FINMA also welcomes the amendment to the Capital Adequacy Ordinance (CAO) proposed by the FDF, which is currently under consultation; it provides for higher capital adequacy requirements for residential property, taking into account for the first time the financial sustainability of loans.

However, the level of provisions for default risks remains very low, and does not reflect the deteriorating economic environment. FINMA is proactively imposing stricter capital adequacy requirements, both across the system as a whole and in respect of specific institutions, in order to increase the latter's robustness and risk capacity.

Strong franc and a difficult market situation

There are initial signs that solutions for cross-border financial services are emerging at banks involved in asset management. However, the reassessment of wealth management business with foreign clients and adjustments to the corresponding business practice and processes will absorb a large amount of resources for some time to come. The strength of the Swiss franc and unfavourable market developments are also squeezing assets under management. As a result, earnings from commissions, service fees and trading are markedly lower than in previous years.

Investment banking, too, faces major challenges. It is impossible to generate high earnings in the recent market environment, while the new capital adequacy rules will also have an impact on this business segment.

Small institutions in particular are finding it increasingly difficult to meet the regulatory requirements while maintaining their long-term profitability. FINMA therefore expects a certain amount of market consolidation. The speed and extent of this process will start to become clear in the near future, as the economic and political situation develops.

A fine-tuned supervisory approach

In banking supervision, 2011 saw the implementation and refinement of newly developed supervisory instruments, which have enabled banking supervision to become substantially more effective without a major increase in resources.

In its report on 'Effectiveness and Efficiency in Supervision', published on 21 April 2011,[14] FINMA detailed its new approach and instruments. Their implementation has led to a significant evolution in banking supervision. The systematically risk-oriented approach means that instruments such as supervisory reviews[15] are deployed where they can achieve the greatest effect, based on risk assessment.

The consequence of this supervisory approach is that the same instruments are applied to all banks, but the intensity of their application varies in line with the banks' risk classification. UBS and Credit Suisse, both of which are in supervisory

[14] See http://www.finma.ch/e/finma/publikationen/Documents/br-aufsicht-20110421-e.pdf.
[15] See section on 'Supervisory reviews', p. 39.

Overview of bank categorisation

Category/ criteria	1 Extremely large, important and complex market participants	2 Very important, complex market participants	3 Large and complex market participants	4 Medium-sized market participants	5 Small market participants	6 Market participants not subject to prudential supervision
	Very high risk	High risk	Significant risk	Average risk	Low risk	
Specific criteria (3 of 4 criteria must be met)	**Balance sheet total** ≥ CHF 500bn **Assets under management** ≥ CHF 1,000bn **Privileged deposits** ≥ CHF 30bn **Required equity** ≥ CHF 20bn	**Balance sheet total** ≥ CHF 100bn **Assets under management** ≥ CHF 500bn **Privileged deposits** ≥ CHF 20bn **Required equity** ≥ CHF 2bn	**Balance sheet total** ≥ CHF 15bn **Assets under management** ≥ CHF 20bn **Privileged deposits** ≥ CHF 0.5bn **Required equity** ≥ CHF 0.25bn	**Balance sheet total** ≥ CHF 1bn **Assets under management** ≥ CHF 2bn **Privileged deposits** ≥ CHF 0.1bn **Required equity** ≥ CHF 0.05bn	**Balance sheet total** < CHF 1bn **Assets under management** < CHF 2bn **Privileged deposits** < CHF 0.1bn **Required equity** < CHF 0.05bn	–
No. of institutions supervised in this category	2	2	approx. 30	approx. 70	approx. 265	–

status as of December 2011

category 1, consume roughly half of the resources and management capacity of banking supervision.

To enable it to react rapidly and appropriately in serious cases, FINMA enhanced its existing range of instruments by creating a new team. The aim of this group, named Team Intensive Supervision (TIS),[17] is to act quickly in acute crises and reach a decision on whether the institution concerned can be returned

UBS trading losses

Rapid intervention was required towards the end of the third quarter. On 15 September 2011, UBS announced a loss of around two billion US dollars resulting from prohibited transactions in the equity derivatives business of its London office. This event triggered a whole series of investigations involving the City of London Police, UBS itself and FINMA. FINMA and the British banking supervisory authority (FSA UK) ordered an investigation of the event and its causes to be carried out entirely independently of the bank and its audit firm. FINMA and the FSA set out the remit for the investigation, which began at the beginning of October 2011. In mid-December 2011, FINMA published a newsletter to market participants[16] specifying its expectations in terms of dealing with operational risks. The final report of the investigation is scheduled for completion at the end of March 2012 and will comprise the results of the investigation and recommendations based on them. FINMA will take account of any new lessons from this incident in its supervisory activities.

[16] See FINMA Newsletter 31 (2011) 'Unauthorised trading – banks' dated 13 December 2011 (http://www.finma.ch/e/finma/publikationen/Documents/finma-mitteilung-31-2011-e.pdf).
[17] See section on 'Team Intensive Supervision', p. 41.

to ordinary supervision. If this is not possible the TIS must make preparations for prompt enforcement proceedings.

Finally, a critical assessment of collaboration with audit firms[18] was carried out. Under the Swiss system, around two thirds of the human resources involved in supervision of the large banking groups are those of audit firms. At smaller institutions, the ratio is tilted even more towards the audit firm. This situation, which will in essence be maintained, necessitates clear management of interfaces and expectations.

Changes in banking regulation

The regulatory projects that are currently being pursued or have already been implemented are the result of a systematic risk orientation and new international regulations. The more important an institution is, the stricter the rules it will be required to satisfy. New provisions on bank insolvency are also to be drafted.

Following a public consultation process conducted in the first quarter of 2011, FINMA brought Circular 2011/2 'Capital buffer and capital planning – banks'[19] into force on 1 July 2011. To assist institutions in implementing the Circular, FINMA published a collection of frequently asked questions on interpretation on 29 June 2011.[20]

Differentiated capital buffers

The capital buffers required by the FINMA Circular under Pillar 2 of Basel II are graded according to four objective criteria using a risk-based approach. The balance sheet total is used as a measure of complexity, and assets under management are an indicator of reputational risks, while the level of privileged deposits reflects the potential risks for individual clients and the depositor protection scheme. Finally, the criterion of required equity is used to reflect the institution's risk profile. Depending on the various criteria, institutions are divided into supervisory categories 2 to 5. Category 1 is reserved for the two large banking groups, which are subject to separate rules.[21]

The capital buffers are structured using a differentiated system; institutions can make varying use of them and top them up at different speeds depending on the situation. The intensity of the supervisory measures taken by FINMA in response to an unintended failure to comply with the capital buffer will depend on whether only the capital ratio that determines the capital adequacy target is undershot or whether a lower limit also defined in the Circular is breached as well, thereby triggering direct and intrusive measures.

Forward-looking capital planning

Subject to considerations of proportionality, the Circular requires all institutions to engage in forward-looking capital planning covering a period of at least three years, taking account of both forecast business (basic scenario) and a downside scenario (stress scenario). Banks are required to develop a stress test of their own for the entire institution. The Circular thus ties in with the stress testing required under Pillar 2 by the BCBS framework.

The levels of the capital adequacy targets set out in FINMA Circular 2011/2 are already attuned to the new capital requirements of Basel III. Institutions in category 5 are not required to hold a buffer higher than that stipulated in the Basel minimum requirements under Pillar 1, but those in the other categories are. The Circular thus makes an important contribution to strengthening the Swiss financial system.

[18] See section on 'Auditing', p. 30.
[19] See http://www.finma.ch/e/regulierung/Documents/finma-rs-2011-02-e.pdf.
[20] See http://www.finma.ch/e/faq/beaufsichtigte/pages/faq-eigenmittelpuffer-kapitalplanung-banken.aspx.
[21] See table 'Overview of bank categorisation', p. 35.

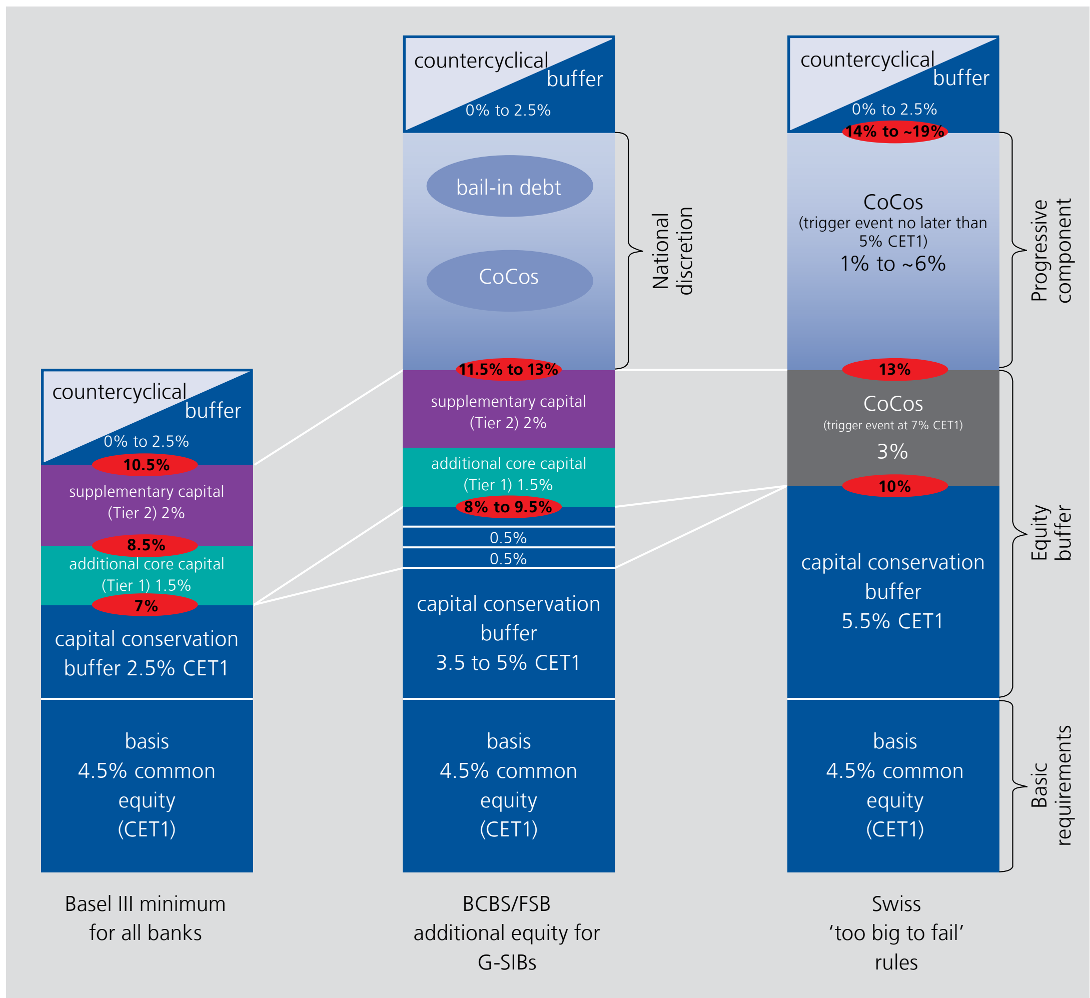
Switzerland implements Basel III

At the end of 2010, the BCBS issued its revised capital adequacy framework Basel III, which will come into force in January 2013. To enable implementation in Swiss law on that date, a national working group headed by FINMA drafted a proposed revision to the Capital Adequacy Ordinance and the associated implementing provisions (FINMA circulars). The proposal also incorporated amendments to the risk diversification guidelines, closely based on international rules such as those that apply in the EU.

The proposal focuses primarily on the implementation of the international regulations on capital adequacy and risk diversification without special rules for Switzerland. Accordingly, the isolated deviations from international regulations that had existed for historical reasons since the introduction of Basel I at the end of the 1980s, and which have hitherto been grouped together under the term 'Swiss Finish', are to be removed.

'Too big to fail': an important step forwards

Parallel to the implementation of the Basel III framework, a consultation was opened on the statutory rules on systemically important banks designed to mitigate the 'too big to fail' issue in the Banking Ordinance and the Capital Adequacy Ordinance,[22] the aim being to pass these in 2012. The key points include measures to strengthen the capital base with more loss-absorbing capital and improved risk diversification to reduce inter-



[22] See section on 'Systemically important institutions: more equity capital is essential', p. 17.

dependencies within the banking sector. There are also organisational measures intended to ensure that systemically important functions such as payment services can continue to operate if there is a threat of insolvency. The relationship between equity capital and organisational requirements is a particularly close one: if the bank falls below a certain capital ratio (trigger), an emergency plan is normally triggered, thus ensuring that the continuance of systemically important functions is guaranteed. Simultaneously, the bank's convertible capital (CoCos) is converted into common equity (CET1). The public consultation on the proposed revisions opened at the beginning of December 2011; the revisions are expected to come into force in 2012. Special measures on liquidity, the basis for which has also already been laid down in the Banking Act, will be presented during 2012 in the form of a separate liquidity ordinance.

The diagram on page 37 shows the Basel III minimum equity standards for all banks and global systemically important banks (G-SIBs) and compares them with the Swiss 'too big to fail' rules.

In the basic component, the special requirements for Swiss systemically important banks amount to 4.5% of risk-weighted assets (RWA). Only CET1 is eligible in the basic component. The buffer component comprises 8.5% of RWA and must normally be fulfilled using CET1. Up to 3% of RWA can also be made up of CoCos, provided that conversion to CET1 or the write-down of debt generating CET1 is triggered at a CET1 level of 7% of RWA. There is also a progressive component to be met using CoCos that convert no later than at a CET1 level of 5% of RWA. The level of this component depends on the overall size, consisting of total assets and certain off-balance-sheet items as well as the bank's market shares in domestic deposit-taking and lending, with a minimum of 1% of RWA that must always be maintained. When needed, there is also a countercyclical capital buffer similar to that which also applies to non-systemically important banks. Compared with the common proposals of the BCBS and the FSB for global systemically important financial institutions, adopted by state and government heads at the G-20 summit in Cannes in November 2011, between 0.5% and 2% more CET1 is required in Switzerland to give a minimum of 10% eligible capital.

Supervisory reviews

On-site inspections (supervisory reviews), one of the key instruments of banking supervision, were further developed during 2011 and deployed more intensively, especially as comparative assessments. FINMA monitors closely the implementation of corrective measures taken in response to the shortcomings revealed.

In 2011, FINMA made even greater use of supervisory reviews than in the previous year: more than 40 were completed, roughly half of them at the two big banks – almost twice as many as in 2010. The reviews examine the control environment in the relevant areas. Where necessary, FINMA instructs institutions to remedy shortcomings. The increased intensity and depth of the reviews highlighted numerous problem areas, and FINMA is closely monitoring the steps taken to secure rapid and sustainable remediation.

Important comparisons between banks

Whenever appropriate, FINMA carries out the reviews on a comparative basis, auditing two or more banks using a virtually identical plan. This renders it considerably easier to identify weaknesses and also makes it possible to establish which banks are employing best practice so that others can be brought as close as possible to this standard. Essentially, FINMA expects every bank to put in place a control environment that reflects the size and complexity of its business activities and enables all relevant risks to be adequately controlled and limited. If FINMA identifies a risk that, in its estimation, poses a danger to the solvency or reputation of the institution concerned should a specific event occur, it immediately instructs the institution to take corrective measures. Supervisory reviews, like stress tests,[23] are a key instrument in this process.

Annual review of the instrument

The spectrum of themes covered in 2011 ranges from interest-rate risks, residential mortgages, trade finance and cross-border business with private clients to various aspects of investment banking. Themes and institutions are chosen using the risk-based supervisory approach, taking account of market-specific and institution-specific factors.

The supervisory review process is reassessed annually and, where necessary, revised. FINMA regards it as a rapid, flexible, yet standardised instrument for fulfilling its goal of intense and risk-oriented supervision leading to corrective measures. Moreover, those banks that are subjected to a comparative review are able to establish the extent to which they conform to best practice.

[23] See section on 'Stress tests', p. 40.

Stress tests

Since 2009, FINMA has been carrying out regular stress tests to evaluate the ability of Switzerland's two big banks to resist shocks. In view of their systemic importance, the two banks are expected to demonstrate a particularly high level of crisis resistance. Since 2011, similar stress analyses of other important Swiss banks have been carried out as well.

Since the beginning of 2009, FINMA has been carrying out regular stress tests of the two big banks. Such loss potential analyses are an important component of regular supervisory activity. FINMA expects Credit Suisse and UBS to hold sufficient capital and liquidity buffers to absorb unforeseen events at any time. The stress analyses examine the ability of the buffers to withstand stress scenarios and place them in the context of multi-year capital planning and comprehensive liquidity analysis. They also take account of future regulatory adjustments resulting from the introduction of Basel III and the 'too big to fail' legislative proposal.

Multi-year stress scenarios

The multi-year stress scenarios are developed in consultation with the SNB and adjusted regularly to reflect changes in the environment. Owing to the systemic importance of Credit Suisse and UBS, FINMA expects them to demonstrate an exceptionally high level of shock resistance, by both national and international standards.

The structure of the loss potential analyses carried out at the two Swiss big banks is essentially similar to the European stress test exercise coordinated annually by the European Banking Authority (EBA) for the most important banks in the eurozone. However, FINMA's loss potential analysis is tailored to the risk profiles of the two Swiss big banks and their importance to the country's financial sector. It is a fixed part of the ongoing supervisory process and, in particular, is carried out using a stress scenario that is significantly more demanding than that in the eurozone. For this reason, the results are not comparable.

Specific mortgage stress tests

Stress tests are a valuable supervisory instrument, enabling FINMA to work with institutions to carry out a transparent analysis of their capital and liquidity situation and identify any measures that may be necessary. However, their use is very resource-intensive, for both FINMA and the institutions. Since the beginning of 2011, FINMA has expanded the scope of the stress tests' application, conducting extensive loss potential analyses at other important Swiss banks as well. Due to the particular situation in the Swiss mortgage market, specific stress tests are also being carried out on the mortgage portfolios of individual institutions to test their resistance to a massive deterioration in the economic environment.

Stress analyses are carried out on the basis of estimates and simulate only some of the possible developments. The results of stress tests therefore need to be integrated into the supervisory process and compared with complementary assessments. They can only be interpreted correctly within the overall context, taking account of all the information used and assumptions made. Conflicts may also arise between the desire to publish stress test results and their use as a supervisory instrument. FINMA therefore has a consistent policy of not publishing stress test results.

Team Intensive Supervision

Not all institutions will necessarily be able to survive in the difficult financial conditions of the years ahead. In future, FINMA aims to respond to acute difficulties at institutions using a specialised group named Team Intensive Supervision.

In the years ahead, the financial sector may continue to face a difficult earnings situation combined with increasingly stringent regulatory requirements. In such an environment, the survival of small and medium-sized banks and securities dealers in particular cannot be taken for granted. FINMA expects the market in this segment to consolidate, but also the number of crises at institutions to increase. This trend poses considerable risks for creditors and investors. FINMA aims to respond by deploying a newly created team specialising in institutions in difficulty: the Team Intensive Supervision (TIS).

New forms of direct supervisory activity

The task of the TIS will be to investigate the causes of problems and oversee crisis management. The primary objective in all cases will be to put a swift end to the crisis in order to prevent loss or damage and minimise the use of resources. Crises can be ended in a number of ways: at some institutions, the introduction and strict monitoring of corrective measures will suffice; in other cases, the correct response may well be to leave the supervised sector. Elsewhere, the investigation may reveal that compulsory measures under supervisory law are the only way to resolve the situation. In this case, the TIS will present the results of its investigations in such a way that swift and effective enforcement proceedings can be conducted.

The TIS will deploy the means of direct supervision: it will carry out on-site investigations, and identify and interact with all relevant parties. The TIS began its work on 1 July 2011, when the first member was appointed. Further members have since joined the team. The TIS is interdisciplinary in character and should comprise not only external experts but also staff from within FINMA. It is envisaged as a crisis specialist that can relieve the burden on FINMA staff at various levels. The resources of line supervisors will no longer be disproportionately taken up with a crisis-hit institution, to the detriment of the supervision of other institutions. In cases where the application of compulsory measures under supervisory law appears possible, the use of the team is intended to enable a speedy handover to the Enforcement division.

The TIS has been fully operational since the fourth quarter of 2011. It has so far been deployed twice, carrying out on-site investigations that led to important findings concerning weaknesses at the institutions concerned. In one case the necessary corrective measures have already been implemented and the institution returned to regular supervision. In the second, the information gathered about the institution and the preliminary work carried out by the TIS would have resulted in prompt revocation of licence had the institution itself not decided to abandon its business and return its licence. The experience gained so far confirms the expectation that this method of intervention in crisis situations will assist in their rapid resolution.

INSURANCE COMPANIES

Overview of insurance companies

Insurance companies faced considerable challenges in 2011. Historically low interest rates are posing considerable problems for life insurers in particular. With a view to taking corrective action, FINMA stepped up its controls and the frequency of its on-site visits.

Low interest rates, which have now persisted for some time, hold sway over the financial situation of insurance companies. Low yields are depressing margins. This is having an especially negative impact on life insurers, which have to generate high returns in order to finance the technical interest rates granted in the past. Low interest rates are also resulting in high valuations of liabilities and thus a reduction in equity for those life insurers that have not implemented the principle of matching assets and liabilities maturities. This has even created a shortfall in capital coverage according to the SST for some life insurance firms.

Negative consequences of the euro crisis

The financial risk attached to bonds issued by heavily indebted states is affecting all insurance companies. However, the direct exposure of companies that operate exclusively in Switzerland is within reasonable limits. Some internationally active insurance groups, on the other hand, have greater exposure to the highly indebted states in which they operate. More worrying is the indirect exposure of life insurance firms by reason of their considerable involvement in the banking business. The second-round effects of any sovereign debt crisis might negatively affect individual life insurers via this channel. The turmoil on the financial markets in August 2011 (low interest rates, high spreads and volatile exchange rates) led to a number of losses subject to reporting[24] among insurance companies. These give some idea of what impact potential third-round effects might have.

More efficient insurance supervision

FINMA's efforts to improve the effectiveness and efficiency of supervision have brought about marked changes in the supervisory approach for insurance. Since no companies belong in supervisory category 1, FINMA has allocated the supervised companies to supervisory categories 2 to 5. The main allocation criteria are the balance sheet total and the company's complexity. Companies allocated to categories 2 and 3 represent roughly 85% of the market in terms of premium volume or balance sheet total. Complementing this categorisation according to risk impact for policy holders and for the system as a whole is a company-specific FINMA internal rating based on quantitative and qualitative parameters, which is still in the process of being implemented.

[24] See FINMA Circular 2008/44 'SST', margin nos. 183–188.

Overview of insurance categorisation

Category/ criteria	1 Extremely large, important and complex market participants	2 Very important, complex market participants	3 Large and complex market participants	4 Medium-sized market participants	5 Small market participants	6 Market participants not subject to prudential supervision
	Very high risk (systemically important institutes)	High risk	Significant risk	Average risk	Low risk	
Specific criteria	–	**Balance sheet total** > CHF 50bn or complexity	**Balance sheet total** > CHF 1bn or complexity	**Balance sheet total** > CHF 0.1bn or complexity	**Balance sheet total** < CHF 0.1bn or complexity	–
No. of institutions supervised in this category	–	5	35	59	143	–

status as of December 2011

The resources for FINMA's direct supervisory activity are assigned mainly to risk categories 2 and 3 and to the companies that FINMA believes warrant special attention in view of their current risk situation.

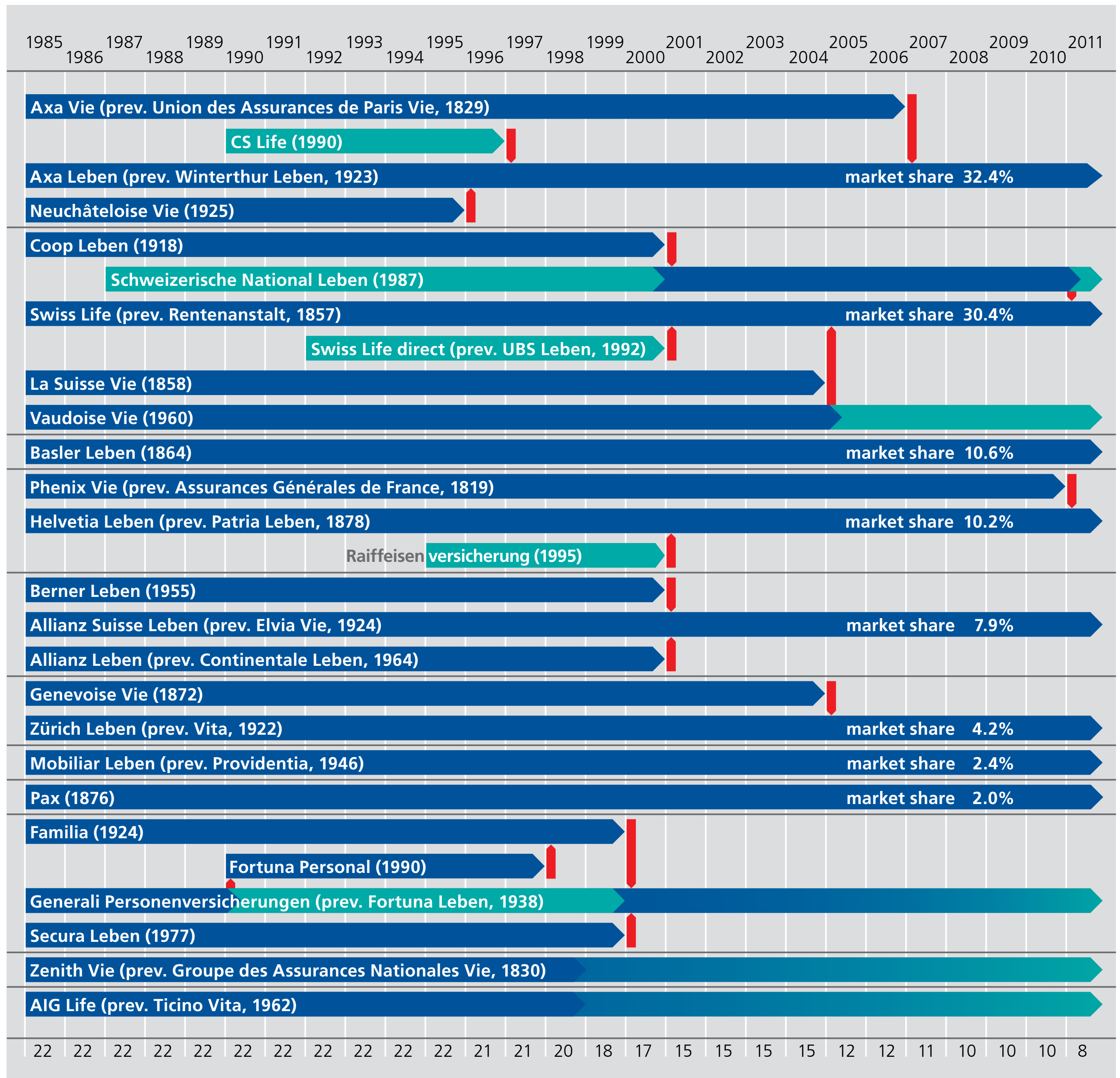
Life insurance: difficult environment

Despite continuing difficulties in the market environment, life insurers had a relatively good year in 2010. The statutory annual profit for 2010 was unchanged year-over-year at CHF 1.2 billion. Various life insurers had taken action with regard to capital or risks in view of the compulsory introduction of the SST on 1 January 2011. As a result, the aggregate SST ratio increased from 117% to 145%. Meanwhile, the traditional life insurance business model with capital and interest guarantees is proving problematic in the present low-interest environment. Yields fell to even lower levels, particularly for long maturities.

Ten-year Confederation bonds

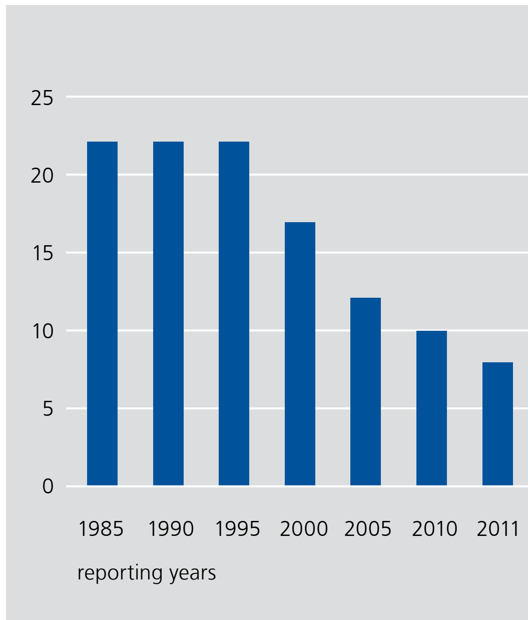
Cut-off date	Yield
1 January 2010	1.97%
1 January 2011	1.65%
1 January 2012	0.75%

Overview of life cycles of Swiss life insurers with occupational pensions activities



- Life insurers with group occupational pension schemes and private 3a and 3b retirement savings
- Life insurers with only private 3a and 3b retirement savings
- Merger or acquisition of occupational pension scheme portfolios

Classification of life insurers according to market share, measured by premium volume reported in 2010 for occupational pension schemes



Number of life insurers active in reinsurance for occupational pensions

Uncertainty on the investment side increased further in 2011. While higher income from foreign currency investments is being eroded by expensive hedging, many borrowers' credit risks have increased markedly. Life insurers are attempting to reduce their dependence on interest rates, for example by bringing new products[25] to the market for selected target groups, such as high net worth individuals, and offering flexible occupational pension solutions for small and medium-sized firms without taking on market risk.

The life insurers' significant exposure in the reinsurance of occupational pensions business (69% in 2010, up from 56% in 1996) opens up an additional avenue for political risks as life insurers operate in a sensitive area with strong links to social security. Moreover, their room for manoeuvre is restricted further by the high conversion rate and legal requirements. Since significantly increased equity capital as well as sophisticated and therefore expensive IT systems are also needed, the number of life insurers involved in the occupational pensions business has fallen. There has been a clear trend towards private insurers pulling out of this business for some years now (see charts[26] on this double page).

Non-life insurance: a good year

The statutory result for non-life insurers in 2010 was very good in comparison, at CHF 7.1 billion. However, there is evidence of increasing competition and a search for new business fields in non-life insurance. For example, cantonal building insurance organisations are starting to operate beyond the bounds of their monopoly. FINMA deems such activity to be subject to the Insurance Supervision Act and thus to supervision by FINMA. It has therefore taken steps to place the relevant cantonal building insurers' private insurance business under its supervision. On 6 July 2011, it granted an operating licence to a subsidiary of a leading building insurer. An appeal lodged against the licence by the insurer's competitors was not taken up by the Federal Administrative Court at the end of 2011. The deadline for contesting this decision at the Federal Supreme Court has, at the time of going to press, not yet passed.

FINMA carried out on-site inspections of motor vehicle insurers' compliance with the legally and technically correct application of pricing differences according to the nationality criterion. With regard to natural hazard insurance,[27] which is standardised and binding for all providers, FINMA stepped up its efforts to ensure compliance with the legal requirements governing quotes and insurance contracts. Furthermore, on-site inspections were carried out in addition to the usual supervisory activity at 29 insurance companies dealing with key supervisory issues such as technical provisions and operational risk.

Reinsurance: stable in spite of natural disasters

In reinsurance, the first quarter of 2011 was dominated by a spate of natural disasters. As expected, most of the larger Swiss-based reinsurers were affected. However, they were able to

[25] For example, through unit-linked life insurance with tailored capital and interest guarantees, capitalisation transactions or differentiation by insured death risks, e.g. smoking and body mass index (BMI).
[26] The two charts do not contain any life insurers that received their licence after 1985 and have only been active in individual insurance.
[27] Art. 33 ISA and Art. 171 f. ISO.

absorb the losses relatively well with no danger of insolvency, thanks in part to significant increases in premium rates in the segments and regions concerned. Premium rates in other areas failed to improve. Particularly in liability insurance, terms are considered unsatisfactory; this is partly due to the persistently low level of interest rates.

Switzerland's appeal as a base for reinsurers is as strong as ever. The solvency situation of reinsurance companies in Switzerland is good. Overall, their SST ratio shows a substantial coverage surplus, although various extraordinary changes in risk-bearing capital are tending to reduce this surplus.

Health insurance: no scope for lower tariffs

Health insurers have to calculate their provisions using recognised methods so that they are able to provide the promised insurance benefits at all times.[28] By 2013, FINMA will review the provisions of all providers of supplementary health insurance as well as the methods used to calculate them, in the interest of protecting policy holders.

The introduction of a new hospital financing scheme has sparked public debate in recent months over the premiums charged for supplementary hospital cover. FINMA has repeatedly stressed that this element should not be viewed in isolation because further important changes are on the way that could have a positive or negative impact on health care costs. FINMA does not see sufficient grounds to order tariff reductions in view of the changes that have been announced. It can only force an insurance company to adjust premiums if reliable data and substantiated forecasts suggest that the company is no longer in compliance with the legal framework.[29] In the meantime, FINMA is keeping a close eye on developments and will conduct a specific survey in 2013 to analyse the first measurable effects of the changes.

[28] See FINMA Circular 2010/3 'Health Insurance under ISA' (in German at http://www.finma.ch/d/regulierung/Documents/finma-rs-2010-03-d.pdf).
[29] Art. 38 ISA.

Changes in insurance regulation

A number of changes to the Insurance Supervision Act (ISA) came into force on 1 September 2011. These mainly concern a reallocation of responsibility and the handling of bankruptcies of insurance companies supervised by FINMA.

FINMA intends to improve insurance supervision legislation over the medium term so as to increase protection accorded to policy holders, eliminate contradictions and move towards international compatibility.[30] The practical application of the completely revised Insurance Supervision Act[31] and the related federal ordinance (Insurance Supervision Ordinance [ISO]), the strategic orientation of FINMA and developments in international coordination among supervisory authorities highlight the need for action as far as regulations are concerned.

Reallocation of responsibility in relation to insurance bankruptcies

Under the rules that have applied until now, bankruptcies of insurance companies have involved complex interaction between FINMA and the bankruptcy judge. Formal responsibility lay with the judge, but FINMA had co-determination rights that had to be taken into account when opening bankruptcy proceedings and assigning a bankruptcy administrator. In particular, a judge could only open proceedings once FINMA had agreed to them.

The new rules are similar to those for banks in that FINMA will have sole responsibility for the opening and conduct of bankruptcy proceedings concerning insurance companies under its supervision.[32] This removes the split of responsibilities albeit with the option of involving third parties. Insurance bankruptcies in future will thus be conducted by the body that, through its day-to-day supervisory activity, has more experience and in-depth knowledge of the companies in question than a cantonal bankruptcy authority. FINMA's task is now to draft the required implementing provisions.

This partial revision also resulted in certain additional and amended provisions in the Insurance Supervision Act that do not relate directly to insurance bankruptcies but affect the right to take measures in general. For example, FINMA will have an explicit legal basis for rectifying coverage shortfalls in tied assets by reallocating the insurance company's assets up to the required amount and for ordering a moratorium and the postponement of maturities in cases where there is a danger of insolvency.[33] In addition, the legislator has made it clear that the revocation of a company's licence will result in that company being wound up, with FINMA appointing a liquidator.[34]

Provisions in reinsurance

Circular 2011/3 'Provisions in reinsurance' applies to all Swiss reinsurance companies and reinsurance captives for reinsurance accepted and ceded as well as to all Swiss direct insurance companies for business accepted and ceded in reinsurance. It essentially regulates the formation and liquidation of technical provisions in reinsurance business and sets minimum requirements for determining such reserves, in particular with regard to their nature and size.[35]

[30] In particular in terms of equivalence with EU and IAIS principles. See also section on 'Recognition of the equivalence of Swiss insurance supervision', p. 50.
[31] In force since 1 January 2006.
[32] See section on 'Insolvency regulations for the financial market', p. 27.
[33] Art. 51 para. 2 lets. h and i ISA.
[34] Art. 52 ISA.
[35] In accordance with Art. 16 ISA.

The second Swiss Qualitative Assessment

As part of the integrated supervisory approach, the Swiss Qualitative Assessment (SQA) provides FINMA with a more complete picture of the insurance companies under its supervision. It helps identify how governance and risk management are organised and implemented.

The SQA, which focuses on qualitative rather than financial factors, complements the SST. It also serves as a measurement basis for determining a company's rating within the risk categories that form part of the FINMA supervisory approach.

First tranche of insurers assessed

FINMA published a market overview[36] in February 2010 containing the results of the first SQA[37] and announced SQA II[38] in December 2010. FINMA assessed the first insurance companies selected for SQA II in 2011. Further assessments will follow in 2012 and 2013. In contrast to SQA I, SQA II will not apply to all companies. Insurers are selected according to both risk-based and random principles. However, the obligations mentioned in FINMA Newsletter 17 regarding governance, risk management and internal controls must of course be met by all companies, regardless of whether or not they are subject to SQA II.

Tailored valuation process with risk dialogues

SQA II is based on SQA I, but it goes further, using special modules and involving various people from different areas and levels of the company. This means that SQA II employs a 360-degree approach, giving FINMA better insight into the operational implementation and suitability of the company's governance, risk management and internal controls. The modular approach facilitates a tailored valuation process that is better able to take account of each insurer's specific risk areas. SQA II places particular emphasis on a company's board of directors as well as on the systems and processes for steering and controlling risks and for complying with laws and regulations. In addition to the written assessments, FINMA can conduct risk dialogues with selected insurance companies in order to discuss topics covered by SQA II. FINMA can also force an insurance company to carry out a self-assessment or commission a third-party assessment in line with its prescribed standards.

SQA II, together with ongoing supervisory activities, underscores the importance FINMA attaches to corporate governance, risk management and internal controls in the organisation and business operations of the institutions it supervises. Should an institution show evidence of deficiencies in these areas, fail to make sufficient progress or display an increased risk profile, FINMA can step up its supervision of that institution and take appropriate action.

[36] See http://www.finma.ch/e/finma/publikationen/Documents/bericht-sqa-20100201-e.pdf.
[37] See FINMA Newsletter 5 (2010) (http://www.finma.ch/e/finma/publikationen/Documents/finma-mitteilung-05-2010-e.pdf).
[38] See FINMA Newsletter 17 (2010) (http://www.finma.ch/e/finma/publikationen/Documents/finma-mitteilung-17-2010-e.pdf).

Group supervision and international developments

International developments in today's insurance sector are global in scope. The focus is on the International Association of Insurance Supervisors, but the Financial Stability Board is also showing an ever greater interest in insurance, especially in connection with financial stability issues.

The IAIS focuses on the basic principles of insurance supervision, financial stability and multilateral supervision of insurance groups. Going forward, it will increasingly track and support the implementation of regulatory principles as well. FINMA participates in most of its main committees and subcommittees. In 2011, it also became a member of the newly established Supervisory Forum and the Macroprudential Policy and Surveillance Working Group.

The IAIS General Assembly passed the revision[39] of the 2003 Insurance Core Principles (ICP) on 1 October 2011. These 26 core principles describe how to organise effective insurance supervision and can be applied worldwide. They are not only guidelines for supervisory authorities and an instrument for self-assessment, but also a means for the International Monetary Fund (IMF) to assess the status of each supervisory regime.

Supervision of international insurance groups

In tandem with the issue of systemic risks in the insurance sector,[40] the IAIS started a three-year project in July 2010 to develop a common framework for the supervision of internationally active insurance groups (IAIGs), referred to as ComFrame. This project, led by the Vice-Chair of FINMA, who also chairs the IAIS Technical Committee, reached its first milestone in July 2011 with the publication of a concept paper. ComFrame intends to create the first multilateral framework for the international supervision of insurance groups by the middle of 2013, after which it will have to be calibrated.

Colleges as platforms for the continual exchange of information and opinions

One of the focal points of FINMA group and conglomerate supervision is international collaboration. At the international level, FINMA assumes the group-wide supervisor function for insurance groups that are managed from Switzerland. It also meets regularly with foreign supervisory authorities in Supervisory Colleges to discuss global groups as well as with EU supervisors in the Colleges of Supervisors.

Six Colleges were held in 2011. It has become clear that the importance and perception of the Colleges is growing – not only in Europe, but also on other continents. The call for more frequent information exchange is becoming ever louder, especially among the global Supervisory Colleges of Swiss Re and Zurich Financial Services (ZFS). It was felt that one College per year no longer suffices in these cases, so the group supervisors have held interim College conference calls since 2011. A key issue here is exchanging information in a more timely manner. The Colleges are evolving from annual events to platforms for the continual exchange of information and opinions. Views and analyses on risk management and control systems are of particular interest. Since Switzerland continues to enjoy a conceptual advantage in solvency calculation on an economic basis with the SST, interest in its operational implementation is accordingly high.

Pressure to coordinate supervisory activities is growing on the part of both the EIOPA and the IAIS. It is hoped that ComFrame will enable effective and efficient multilateral supervision of internationally active insurance groups. Special attention has to be paid to the complexity of these insurance groups' multi-locality activities.

[39] See http://www.iaisweb.org/__temp/Revision_of_the_ICPs_-_Process_for_Review_and_Consultation.pdf.

[40] See section on 'Systemically important institutions: more equity capital is essential', p. 17.

Recognition of the equivalence of Swiss insurance supervision

In 2011, the EIOPA tested the Swiss insurance supervision regime for equivalence with the Solvency II Directive. Its findings were positive, but the European Commission's decision is still pending.

At the beginning of 2011, FINMA answered a detailed catalogue of questions[41] from the EIOPA on insurance supervision in Switzerland as the first step in an extensive assessment of FINMA's application for equivalency. In addition to questions on FINMA's legal form, organisation, aims, tasks and resources, as well as its general orientation and conduct of insurance supervision, special emphasis was placed on the supervision of reinsurance, group supervision and the SST. After further questions were answered, EIOPA representatives from various jurisdictions got a more detailed look during a two-week visit to FINMA's headquarters.

Equivalence with caveats

The EIOPA passed its advice[42] to the European Commission at the end of October 2011. It declared itself in favour of 'equivalence, but with certain caveats'. The definitive EU decision is still pending. These caveats primarily concerned the following points:

– insufficient public disclosure requirements for insurance companies;
– scope for exemption from the duty to appoint internal auditors;
– insufficient anchoring of the compliance function in supervisory law.

These remarks will be taken into consideration in the decision-making process for the further development of the Swiss Insurance Supervision Act (ISA) and Insurance Supervision Ordinance (ISO).[43] As part of the assessment, FINMA published its policy on the Supervisory Colleges in the insurance sector.[44]

[41] Questionnaire for Equivalence Assessment in relation to Arts. 172, 227 and 260 of Solvency II Directive (2009/138/EC).
[42] See https://eiopa.europa.eu/consultations/consultation-papers/2011/august-2011/consultation-paper-no-3-eiopa-draft-report-equivalence-assessment-of-the-swiss-supervisory-system/index.html.
[43] See section on 'Changes in insurance regulation', p. 47.
[44] See http://www.finma.ch/e/beaufsichtigte/versicherungen/gruppen_konglomerate/Documents/policy-supervisory-colleges.pdf.

MARKETS

Overview of markets

In 2011, FINMA's Markets division ensured the proper functioning of the multi-level supervisory process for collective investment schemes, while also focusing on new technological developments with regard to stock exchanges and securities dealing, and on international regulatory and implementing projects such as the AIFMD and the UCITS IV Directive.

One important trend affecting the proper functioning of the financial markets is the many new technological developments on the stock exchanges and in securities dealing. The advances made in data processing and communications technology have brought about marked changes in the execution and settlement of securities trading transactions. The latest development in this regard is high frequency trading (HFT), where computers carry out thousands of purchase and sale orders independently in milliseconds so as to exploit the smallest of price differences between the various trading venues.

The trading venues themselves are also subject to continual change, in particular multilateral trading facilities (MTF) in accordance with the Markets in Financial Instruments Directive (MiFID), crossing networks and also dark pools. Together with Liquidnet Europe Limited, SIX Swiss Exchange has set up a dark pool for executing block trades. Some 3,600 securities from Switzerland, the UK, France, Germany and the Netherlands can be traded on the SIX Swiss Exchange Liquidnet Service platform. Stock exchanges and alternative trading facilities share a common function, namely to bring together buyers and sellers of securities.

Client protection is the core principle

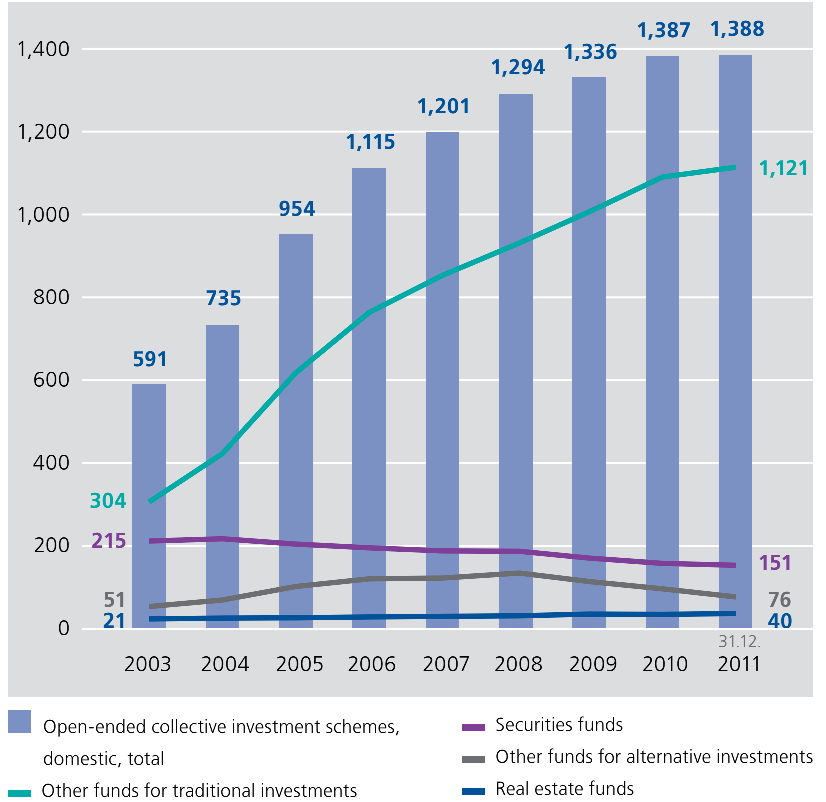
Besides international regulatory and implementing projects such as the AIFMD and the UCITS IV Directive, national developments also placed increasing pressure on market participants with regard to client protection, particularly on the institutional asset management sector. Clients are increasingly only working with authorised institutions, and there are also regulatory intentions only to authorise asset managers subject to supervision. For example, as part of the structural reform to occupational pensions it has been stipulated that from 1 January 2014, only persons and institutions supervised by FINMA or recognised by the oversight committee will be allowed to manage occupational pension schemes.

With the aim of ensuring client protection, FINMA carried out various checks as part of its risk-based supervisory approach to supervised institutions covered by the Collective Investment Schemes Act. One of the issues examined was the proper functioning of the multi-level supervisory process for collective investment schemes. The Collective Investment Schemes Act itself provides mutual monitoring obligations for certain licence holders. For example, the custodian bank of a Swiss collective investment scheme is not only responsible for the safekeeping of assets, it also has a monitoring function[45] in respect of fund management companies and SICAVs that includes monitoring the calculation of the net asset value and verifying whether the investment decisions are in compliance with the Act and the fund contract. In its supervision of custodian banks, FINMA found the performance of monitoring duties by certain institutions to be unsatisfactory or non-existent. It therefore instructed audit firms to make a detailed statement on this in their next audit report. Should the suspected shortcomings be confirmed, FINMA will take appropriate measures.

In the case of fund management companies, FINMA conducted an in-depth review focusing on those that predominantly or exclusively manage real estate funds. FINMA looked at the operational organisation of fund management companies, with particular reference to the professional qualifications

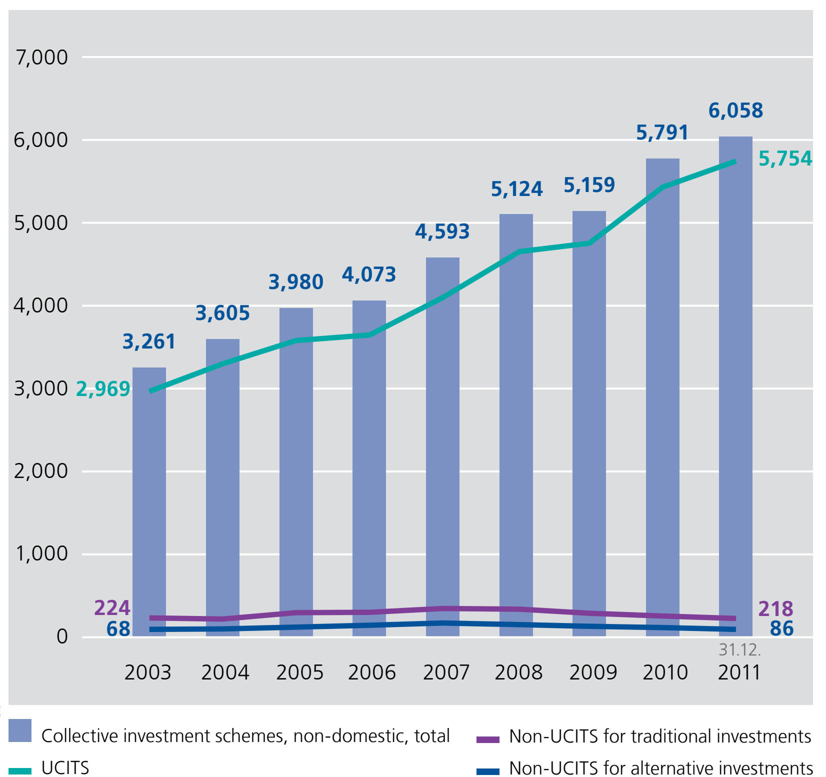
[45] In accordance with Art. 73 para. 3 CISA.

Development of the number of domestic open-ended collective investment schemes between 2003 and 2011 according to fund type



of the persons entrusted with the management of the real estate funds. In the context of real estate funds, FINMA also carried out an in-depth review of the valuation experts that play a pivotal role in the multi-level supervisory process by carrying out objective valuations of properties.

As regards products, no specific trend towards any particular type of collective investment scheme was discernible in 2011. However, there were once again more applications submitted for the authorisation of Swiss products with specific exceptions in respect of investments or investment regulations. There has also been some demand for collective investment schemes established in corporate form, such as investment companies with variable capital.



Development of the number of foreign collective investment schemes between 2003 and 2011 according to fund type

Changes in market regulation

In 2011, Switzerland adopted the EU's new Key Investor Information Document (KIID) to present key information for investors in a concise and comparable form. Moreover, the FINMA Circular 'Disclosure requirements for securities transactions' sets down specific obligations, while the 'Credit rating agencies' Circular redefines FINMA's requirements for various supervisory areas.

Collective investment schemes

As part of the changes to the Banking Act aimed at enhancing depositor protection, amendments were also made to the Swiss Federal Act on Collective Investment Schemes (CISA) of 23 June 2006. Bankruptcies involving fund management companies, SICAVs, limited partnerships and SICAFs now fall under FINMA's competence. The respective modifications entered into force on 1 September 2011. FINMA is thus now responsible not only for compulsory liquidations, but also for instituting and conducting bankruptcy proceedings under the terms of the Collective Investment Schemes Act.[46] The voluntary liquidation of collective investment schemes, however, remains the responsibility of the licence holders.

Introduction of the KIID in Switzerland

Under the terms of the EU's UCITS IV Directive,[47] the simplified prospectus was replaced by the Key Investor Information Document (KIID) as of 1 July 2011. Following this development in international law, the Federal Council decided on 29 June 2011 to introduce the KIID as part of the amendments to the Collective Investment Schemes Ordinance (CISO), which it implemented as of 15 July 2011. The aim of the KIID is to create a standardised and concise document that is understandable for investors, enabling them to make simple and fast comparisons between different collective investment schemes. Subject to the applicable transitional periods, KIIDs are to be produced both for Swiss collective investment schemes of the types 'securities funds' and 'other funds for traditional investments' as well as for foreign collective investment schemes that are comparable with these products and are distributed in or from Switzerland. The guideline on producing KIIDs entitled 'Relevant information for investors in securities funds and other funds for traditional investments in the form of public funds' issued on 2 December 2011 by the Swiss Funds Association (SFA) has to be followed and has been recognised by FINMA as a minimum standard.[48]

Stock exchanges and securities dealers

On 1 August 2011, Article 53a SESTO entered into force, creating a legal basis for the admission of foreign proprietary traders to the Swiss Exchange that is in line with existing FINMA practice.[49] Under the terms of the Stock Exchange Ordinance,[50] FINMA may grant authorisation as a foreign stock exchange member to a foreign proprietary trader who is not subject to appropriate supervision in their country of domicile, provided that they meet the requirements set down in the Stock Exchange Act.[51] Non-supervised foreign proprietary traders must meet both the organisational and personnel requirements as well as the capital adequacy requirements applicable to Swiss securities dealers. In the period from the new Article 53a SESTO entering into force to the end of 2011, FINMA authorised one foreign proprietary trader as a foreign stock exchange member.

Changes to FINMA Circular 2008/11 'Disclosure requirements for securities transactions'

FINMA brought the revised Circular 2008/11 'Disclosure requirements for securities transactions'[52] (formerly 'Reporting obligation – stock exchange transactions') into force on 1 November 2011. The changes focus mainly on making the existing disclosure requirements more precise for

[46] See section on 'Insolvency regulations for the financial market', p. 27.
[47] Directive 2009/65/EC of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).
[48] In the meaning of Article 7 para. 3 FINMASA and Article 20 para. 2 CISA.
[49] See FINMA 2010 Annual Report, p. 65 ff. (German version).
[50] Art. 53a para. 1 SESTO.
[51] Art. 10 para. 2 SESTA.
[52] See http://www.finma.ch/d/regulierung/Documents/finma-rs-2008-11.pdf (German version).

securities dealers. They are not, however, subject to any new requirements. FINMA adapted the Circular in line with new developments and changes to market requirements, specifically eliminating terminological inconsistencies with Swiss stock exchange regulations. In the informal consultations that were conducted, the market participants and providers involved thoroughly welcomed the proposed revisions.

Credit rating agencies

In its Circular 2012/1 'Credit rating agencies'[53] published in August 2011, FINMA revised its conditions for recognising credit rating agencies. The Circular is directed at agencies whose credit ratings are used by authorised institutions for supervisory purposes. Besides governing the supervisory use of credit ratings by banks and securities dealers, particularly when calculating capital adequacy requirements, the Circular now also provides the basis for the use of credit ratings by insurance companies (e.g. in the case of investment requirements for tied assets) and by collective investment schemes (investment techniques and derivatives). FINMA's requirements for credit rating agencies have thus been redefined for various supervisory areas and the conditions for recognition have been standardised. In setting its recognition conditions, FINMA took account of the revised requirements of international standard-setters such as the International Organization of Securities Commissions (IOSCO) and the BCBS in light of the Swiss market environment. The requirements for credit rating agencies specified in the Circular are aimed at providing minimum qualitative credit rating standards. The Circular entered into force on 1 January 2012, with transitional provisions applying for insurance companies until the end of 2014.

[53] See http://www.finma.ch/e/regulierung/Documents/finma-rs-2012-01-e.pdf.

Exchange-traded funds

Due to the increasing complexity of the products, transparency is of great importance in the case of exchange-traded funds (ETFs). Public investors must know which index is replicated by the ETFs in which they are investing.

ETFs have been a popular investment instrument for some years now, among institutional and public investors alike. Swiss and also foreign ETFs authorised for public distribution in or from Switzerland are open-ended collective investment schemes traded on the SIX Swiss Exchange, and for which a market maker ensures liquid trading. If the designation ETF is used for the name of a collective investment scheme, all unit classes must be listed. Another characteristic of ETFs is that they replicate an index, although they can also replicate the performance of an underlying asset such as gold. However, they are not permitted to use the index solely as a benchmark.

Increased transparency for Swiss ETFs

ETFs use different methods to replicate indices: there is a distinction between products that use physical and synthetic replication. ETFs that use physical replication either buy all of the securities in the underlying index (full replication method) or some of them (so-called sampling method). By contrast to physical replication products, those using synthetic structures replicate the index with derivatives. With the ETFs on offer becoming ever more complex, transparency and information for investors are of particular importance. The fund documents of Swiss ETFs must therefore clearly state which replication method is used and how it works. Given that the replicated index determines the risk-return profile of the fund, the fund documents of Swiss products must specifically contain information on the index provider and the composition of the index.

Swap ETFs

Synthetic replication products of the type unfunded swap ETFs also have to disclose their investment policy with regard to the basket of securities. Unfunded swap ETFs do not invest in the securities underlying the index but instead invest their assets in accordance with tax-optimised criteria. The performance of the index is achieved solely using OTC swaps.

Synthetic replication products are also offered in the form of funded swap ETFs. Unlike unfunded swap ETFs, funded swap ETFs do not acquire any securities, and instead transfer their entire assets to one or more swap counterparties, which in turn undertake to deposit collateral corresponding to at least 90% or 95% of the fund's assets and also to pay the index performance. With these products, the question is whether they comply with the defining characteristics of a collective investment scheme.[54] If the entire cash inflow of a funded swap ETF is transferred to a swap counterparty, the ETF has no power of disposal over any investments in the fund's assets, nor does the executive body of the ETF perform any management of the fund's assets. When submitting an application, the applicant must therefore prove that the product in question constitutes a collective investment scheme.

On 21 September 2011, FINMA published Newsletter 29 on exchange-traded funds, in which it informs licence holders, i.e. fund management companies and representatives of foreign collective investment schemes, about the requirements prescribed to obtain approval.[55]

[54] Art. 7 para. 1 CISA.
[55] See http://www.finma.ch/d/finma/publikationen/Documents/finma-mitteilung-29-2011-d.pdf (German version).

Valuation experts of Swiss real estate funds

The valuation experts of Swiss real estate funds must ensure that valuations at market value are conducted independently, professionally and in line with the market.

Swiss real estate funds[56] invest their assets in real estate investments such as land (residential buildings, real estate properties and commercial or mixed-use buildings, building land, etc., referred to below as real estate). The market value of these investments cannot be readily determined. The Collective Investment Schemes Act[57] therefore provides for the fund management company or the SICAV to appoint at least two individuals or one legal entity as valuation experts to value the real estate belonging to the fund in question. Each individual valuation mandate placed with the valuation experts by the fund management company or the SICAV requires FINMA's approval. FINMA therefore generally does not recognise valuation experts, but only in the case of a specific mandate.

Requirements for valuation experts

The valuation mandate is approved if the valuation experts have the required qualifications and are independent. In accordance with consistent FINMA practice, prerequisites for the specialist qualifications being met are proof of pertinent training or other evidence of the necessary expertise, at least five years' experience in the field of real estate valuation, and familiarity with the real estate market in question. Valuation experts must be legally and economically independent from the fund management company, the SICAV, the custodian bank as well as from companies that are connected in any way with those persons or entities or with real estate companies of collective investment schemes managed by the same fund management company, the SICAV or that have the same custodian bank. Economic dependence is assumed as soon as the valuation expert generates more than 10% of their annual income from mandates from a single fund management company or a SICAV or from mandates with related fund management companies or SICAVs. Furthermore, valuation experts must be independent of each other.

The option of appointing legal entities as valuation experts that was created when the Collective Investment Schemes Act came into force has not proven practicable. Given that a legal entity also has to appoint two natural persons as valuation experts for each real estate fund, there is no scope for approving the mandate to a legal entity.

Tasks of the valuation experts

After approval of the valuation mandate by FINMA, the fund management company or the SICAV allocates the real estate to the individual valuation experts. The experts must physically inspect and value the real estate that the fund management company or the SICAV wants to purchase or sell.[58] In the case of properties already belonging to the fund assets, the market value is to be reappraised at the end of each accounting year and each time fund units are issued. The physical inspection is to be repeated at least every three years.[59] Physical inspection by an auxiliary of the valuation expert is permitted only when valuing foreign real estate. The results of the valuation must then be checked by a second valuation expert. These requirements are aimed at ensuring that valuations at market value are conducted independently, professionally and in line with the market.

[56] Art. 58 ff. CISA.
[57] Art. 64 para. 1 CISA.
[58] Art. 92 CISO.
[59] Art. 93 and Art. 97 para. 3 CISO.

Banks' handling of assets of politically exposed persons

FINMA published a short report[60] on the due diligence obligations of banks when handling assets of politically exposed persons and conducted investigations of the banks involved.

In the wake of the upheaval in Arab countries, and acting directly on the basis of the Swiss Federal Constitution, at the beginning of 2011 the Federal Council ordered the freezing of the assets of Messrs Ben Ali, Mubarak and Gaddafi and persons closely associated with them. Many of those listed in the sanction orders are politically exposed persons (PEPs). FINMA received many enquiries concerning the banks' compliance with anti-money laundering regulations and, specifically, their dealings with PEPs. FINMA published a short report on 11 March 2011 entitled 'Due diligence obligations of Swiss banks when handling assets of politically exposed persons', which summarised the key answers to these questions.

Twenty banks investigated

Based on the orders of the Federal Council regarding measures to be taken against certain persons from Tunisia, the Arab Republic of Egypt and Libya, various banks reported assets of persons affected by these measures. Following these reports, FINMA investigated 20 banks to examine on a case-by-case basis whether anti-money laundering regulations had been breached. The results of these investigations revealed differences in the management of the client relationships. Essentially, the banks are aware of their duties and implement them accordingly; in some cases, FINMA's expectations were met in full. However, FINMA found shortcomings in the case of four of the banks investigated, and consequently opened formal enforcement proceedings against these banks. FINMA published the results of its investigation on 10 November 2011.[61]

Strict due diligence obligations

Switzerland adopted concrete rules governing the way in which banks have to handle the assets of PEPs as far back as 1998. These due diligence regulations have been developed continuously ever since, and are now firmly established in FINMA's Anti-Money Laundering Ordinance of 8 December 2010. Business relationships with PEPs are not prohibited, but financial intermediaries are subject to strict due diligence obligations set out in the Anti-Money Laundering Act. They must perform additional clarifications that allow the bank to know the origin and purpose of the assets. They are also obliged to report and freeze assets if they have reasonable suspicion that the assets are of criminal origin. FINMA examines banks' compliance with these due diligence obligations every year – mostly assisted by audit firms – and intervenes in case of non-compliance.

The FATF, which sets the international standards in combating money laundering and the financing of terrorism, agreed to extend the PEP categories when reviewing its 40 Recommendations and 9 Special Recommendations. In addition to foreign PEPs, there will in future also be the categories of domestic PEPs and PEPs in international organisations. Unlike foreign PEPs, an increased reputational risk is not automatically assumed for these latter categories. Instead, risks will be weighted as part of a risk-based approach to the client relationship, while changes are based on the fourth round of country evaluations.

[60] See http://www.finma.ch/e/finma/publikationen/Documents/br-pep-20110311-e.pdf.
[61] See http://www.finma.ch/e/aktuell/Documents/bericht_pep-abklärung_20111110_e.pdf.

ENFORCEMENT

Overview of enforcement

The Enforcement division is responsible for enforcing supervisory law. It also runs FINMA's market supervision operations and handles insolvencies of institutions under FINMA's supervision. Enforcement decisions are made by FINMA's Enforcement Committee.

Enforcement is FINMA's newest division. Since being split from the Markets division on 15 March 2011, it has been responsible for investigations and for enforcing the obligation to comply with the applicable financial market legislation. It conducts enforcement proceedings concerning the supervision of institutions, products and markets and is thus FINMA's sanctioning arm. It also dissolves banks and securities dealers and, since 1 September 2011, insurers and collective investment schemes that have failed financially.[62] Its other responsibilities are disclosure (reporting obligations under stock exchange law) and takeovers.

Investigations and enforcement proceedings

The Enforcement division takes on selected cross-divisional tasks[63] affecting companies and individuals supervised by the Banks, Insurance and Market divisions. The Enforcement division's teams take action where supervisory activities provide a clear indication that supervised institutions or individuals are not complying with the requirements of supervisory law. The teams always have around 300 ongoing investigations. There is a great deal of interaction between the divisions in this respect. At the same time, Enforcement is constantly conducting around 35 formal enforcement proceedings against supervised institutions and individuals in order to clarify in detail suspected violations of the law and order the requisite corrective measures under supervisory law where suspicions are borne out.

Increasing number of procedural appeals

When FINMA opens proceedings, it follows the published Enforcement Policy.[64] Rulings in enforcement matters are generally issued by FINMA's Enforcement Committee. Insofar as FINMA assesses appeals against rulings by the Swiss Takeover Board, the FINMA Takeover Committee decides on these.

The measures available range from declaratory rulings, revoking a supervised institution's licence, liquidating it under supervisory law or ordering its insolvency to prohibiting a natural person from practising a profession. In its role as a bankruptcy authority, FINMA handles bankruptcies of supervised institutions and conducts foreign ancillary bankruptcies. Enforcement employs an external agent as bankruptcy administrator in the majority of cases. Where the volume of bankruptcy assets is small, Enforcement itself acts as bankruptcy administrator.

The many appeals against FINMA rulings are creating a considerable workload for the division. Enforcement charges the cost of opened enforcement proceedings to the parties involved in those proceedings. However, FINMA's expenses cannot be charged to these parties if legal recourse is taken against FINMA's rulings or for investigations.

The Enforcement division often discovers evidence of potential criminal acts, so it fosters contact with the federal and cantonal criminal prosecution authorities. The aim here is to coordinate proceedings and provide mutual legal assistance while also complying with the legal obligation to file complaints in connection with criminal acts. In coordinating proceedings, special importance is attached to the admissibility of evidence.

[62] See section on 'Insolvency regulations for the financial market', p. 27.

[63] For the operating organisation, see section on 'Operational development within FINMA', p. 74.

[64] See http://www.finma.ch/d/sanktionen/enforcement/Documents/pl_enforcement_20111110_d.pdf (German only).

Enforcement statistics

Proceedings: ongoing and changes

	Open as of 1 January 2011	Opened	Completed	Open as of 31 December 2011
Enforcement proceedings against				
licence holders	26	21	22	25
other	15	15	22	8
Liquidations				
licence holders	1	1	1	1
unauthorised institutions	37	6	5	38
Bankruptcies				
licence holders	8	1	0	9
unauthorised institutions	120	17	25	112
Acknowledgement of foreign insolvency measures	5	2	2	5

Revision of the Stock Exchange Act: expanding market supervision

On 1 September 2011, the Federal Council adopted the dispatch on the revision of the Stock Exchange Act. The planned revision proposes a fundamental and far-reaching reorganisation of the monitoring and prosecution of stock exchange offences and market abuse in Switzerland.

In terms of criminal law, the revision of the Stock Exchange Act is aimed at substantially broadening the definition of insider trading (exploiting knowledge of confidential facts). In addition, qualified actions in relation to insider trading and price manipulation are to be classified as crimes in line with the international recommendations put forward by the FATF. Actions whereby the perpetrator (or, in the case of insider trading, the primary insider) achieves an economic benefit of more than CHF 1 million will qualify as crimes. Another key amendment concerns the responsibility for prosecuting stock exchange offences, which will shift to the Office of the Attorney General.

Expanded prohibition of insider trading and market manipulation

In terms of supervisory law, the Federal Council's proposal prohibits insider trading and market manipulation for all market participants, not just for those supervised by FINMA. The same rules of conduct under supervisory law are thus applied to all competing market participants. This is an important correction that has been repeatedly requested by FINMA (and before it the SFBC).[65] It results in particular in market manipulation through 'real' transactions or buy/sell orders (i.e. not fictitious) being generally inadmissible. It should also be noted that the prohibition covers not only transactions in securities as such, but also trades and buy/sell orders in derivative financial instruments (OTC products) or in the underlying assets of derivatives. If these create false signals for the supply, demand or price of securities, they will in future be prohibited as market manipulation. The prohibition of insider trading also bans tactics such as front running and scalping.

Under the Federal Council's proposal, the so-called control premium in public purchase offers will be abolished. This change is to be welcomed: firstly, because it brings Switzerland into line with the standard of international regulation, and secondly because it means that all investors will be treated equally in future. Furthermore, FINMA (or, in takeover matters, specifically the Swiss Takeover Board) is to be authorised to suspend voting rights as a preventive enforcement measure to ensure compliance with reporting obligations under stock exchange law. This change increases the legal security and practicability of applying this measure, which has barely been tried up to now.

Many proposals contributed by FINMA have been incorporated into this draft revision. Other key demands, such as the introduction of an administrative fine, have not. Overall, it can be said that the proposed revision provides a good basis for adequate market supervision of trading activity in securities admitted to trading in Switzerland. However, even if the draft revision is passed into law by the National Assembly, differences will remain regarding the scope of applicability and sanctioning options compared with the standards in force in other strongly regulated financial centres.

Partial revision of the FINMA Stock Exchange Ordinance

From 27 July to 5 September 2011, FINMA conducted a consultation on the draft revision of the FINMA Stock Exchange Ordinance. An overwhelming majority of the six participants were in favour of the proposed revision. The changes essentially concern a more precise definition of the reporting obligation when a threshold value is exactly reached,[66] new rules on the obligation to disclose

[65] See FINMA Annual Report 2010, p. 64 (German version).
[66] See FINMA Annual Report 2010, p. 64 (German version).

shareholdings of foreign collective investment schemes that are not authorised for distribution[67] and the amendment of various procedural provisions.[68] The changes to the FINMA Stock Exchange Ordinance entered into force on 1 January 2012.[69]

Enforcement practice

The Enforcement division is FINMA's sanctioning arm. It intervenes, for example, when unlicensed institutions have to be taken out of business, when deposits are accepted from the public illegally or when anti-money laundering rules are not followed.

FINMA had to conduct investigations and enforcement proceedings mainly in cases of illegal acceptance of deposits from the public, illegal issuing house and insurance activity, unlawful holding companies and violations of the Anti-Money Laundering Act. The bankruptcy or liquidation of companies operating illegally had to be ordered in some cases.[70] Milder measures were sometimes sufficient to restore compliance with the law. For instance, when a company at fault had not published any advertising and had reduced the amount of deposits accepted from the public to below the level deemed to constitute commercial activity, FINMA restricted itself to pointing out the unlicensed activity and instructing the company to pay the deposits back immediately.

Unlicensed institutions: e-money a growing threat

More and more investigations are dealing with the topic of virtual money or e-money. Following on from the international goods trade via the Internet, there is now also a virtual flow of money. However, investors are not always aware that they are paying real money on the Internet and exchanging it for virtual money that is used as a parallel currency. This means that, after paying their real money, customers receive a specific amount of virtual money credited to their account, usually at an exchange rate that is not at all transparent. They can then use this credit to invest or buy goods from affiliated partner firms, supposedly at a discount. It is often practically impossible for them to address problems to the virtual money provider or demand their money back. One Swiss company was selling electronic money issued by offshore firms. FINMA qualifies the activities of such foreign e-money providers as banking activities subject to licensing. Accordingly, the Swiss company in question was deemed to be a representative of a foreign bank and thus also subject to licensing. FINMA ordered the company's liquidation.

The measures ordered by FINMA often have the effect of forcing companies that are operating illegally to cease trading. After this happens, there is a risk that the individuals behind such companies will continue their illegal activity in another form under the names of different companies. In such cases, FINMA can prohibit the individuals responsible for controlling the illegal activity from doing so with an order, the publication of which is restricted in terms of both time and place. The aim here is to take preventive action to protect future investors. FINMA is unable to intervene directly where there is evidence of companies with no presence in Switzerland engaging in activities that are subject to licensing. The practice in recent years has been to add the names of these companies to a blacklist published on FINMA's website. Since September 2011, they have also been published on the IOSCO Investor Alerts Portal[71] so as to ensure that foreign investors are better informed.

[67] Art. 17 para. 3 SESTO-FINMA.
[68] Arts. 21, 22, 23 and 26 SESTO-FINMA.
[69] See http://www.finma.ch/e/aktuell/pages/mm-teilrevision-boersenverordnung-20111220.aspx.
[70] See section on 'Enforcement statistics', p. 59.
[71] See http://www.iosco.org/investor_alerts/.

Licensed institutions: significant organisational deficiencies often found

All supervisory areas were involved in proceedings against licensed institutions: not only banks and insurers, but also audit firms, market participants in the fund industry and other financial intermediaries. Investigations often brought to light significant organisational deficiencies such as inappropriate directives, insufficient compliance in investment processes, a lack of specialist knowledge – for example in the distribution of collective investment schemes – or an inadequate internal control system. In addition, information and due diligence obligations towards clients were being violated. The focus in other cases was on enforcing compliance with the financial licensing requirements by imposing constraints and considerable pressure, which in some instances resulted in the supervised institution voluntarily surrendering its licence. Proceedings are closed with rulings. These brought to bear the full spectrum of measures provided for by law, from reprimands to restoration of compliance with the law, prohibition from practising a profession or revocation of the licence.

For some financial intermediaries directly supervised by FINMA (DSFIs), the question arose as to whether the Anti-Money Laundering Act stipulates lower or equivalent requirements for the assurance of proper business conduct on the part of managers compared with those for banks and securities dealers. FINMA decided to follow the practice established for many years in prudential supervision and work towards a single, rigorous standard. Thus, for example, actions whereby members of a company's governing bodies harm the company for their own material gain were defined as relevant to the assurance of proper business conduct, even if they did not directly result in any disadvantage for investors.

FINMA was kept especially busy in 2011 by violations of anti-money laundering provisions. The supervisory authority identified evidence of insufficient compliance with due diligence obligations on a number of fronts. In particular, many high-risk business relationships and transactions were not sufficiently clarified. Cash transactions were settled with incorrect certification in a number of cases, while the enforcement proceedings on dealing with PEPs must also be mentioned here.[72]

Market supervision: unintelligible prospectuses for structured products

In mid-2011, FINMA carried out a representative check of the prospectuses banks use to sell their structured products. It looked at around 100 prospectuses from 11 market participants. Its findings reveal a negative picture: the majority of prospectuses are hard for the average investor to understand, especially those written in English. There is no standard format across all issuers, even though the legislation demands one. In addition, the simplified prospectus tends to play only a secondary role in the advisory process. Self-regulation has failed to clarify the requirements for simplified prospectuses adequately for investors to be provided with prospectuses that are clearly structured, easy to understand and, above all, that offer a sound basis for comparing products. It is therefore evident that the existing regulatory framework is insufficient.

Consistent response to violations of reporting obligations

In its 2010 Annual Report, FINMA announced that its reporting practice concerning potential violations of reporting obligations under stock exchange law was to become more rigorous. This practice is now being adhered to consistently in that complaints are filed with the FDF in every case where there are grounds to suspect that a criminal violation of reporting obligations has occurred, however minor.[73]

A disclosure report announced that a group led by a well-known investor had unexpectedly exceeded the thresholds of 3%, 5%, 10%, 15% and 20% of voting rights in the listed company sia Abrasives AG. The investigation launched by FINMA revealed that a bank had bought registered

[72] See section on 'Banks' handling of assets of politically exposed persons', p. 57.
[73] See increase in 'Complaints filed with criminal prosecution authorities' under 'Statistics' in the Appendix, p. 83.

shares in the company in order to sell them on to clients who 'parked' them on behalf of the investor. The bank had thus committed a serious violation of its supervisory law obligations concerning organisation and the assurance of proper business conduct, while the investor had failed to observe his disclosure obligation under stock exchange law. The ruling against the investor is legally valid, whereas the bank is appealing the ruling against it before the Federal Administrative Court.

Appeals against rulings issued by the Swiss Takeover Board

Regarding the takeover of Genolier Swiss Medical Network SA, the Takeover Board found that the public purchase offer complied with the provisions of the law. The bidding company was ordered in the appeals process to publish an amended valuation report. Two qualified shareholders raised objections with FINMA as a result. FINMA concluded in its decision that the opinion of an independent third party (a fairness opinion) was to be sought. After the additional details demanded by FINMA were added to the prospectus and the report by the board of directors, the Takeover Board ruled that the additions were compliant with the law. An objection was then raised against this ruling but rejected by FINMA.

Regarding the public purchase offer for Quadrant AG, FINMA decided that the offer from a securities dealer had to be audited by a securities dealer licensed in Switzerland and that a securities dealer only licensed abroad did not qualify as an auditor within the meaning of the Stock Exchange Act.

Insolvency: new powers for FINMA

FINMA's powers to open and conduct liquidation and insolvency proceedings against financial market participants were extended considerably on 1 September 2011.[74] The extent to which this extension of powers will increase the number of insolvency proceedings remains to be seen. For the moment, the focus remains on banks and securities dealers.

Appeals: increasing in number and in technicalities

In general, the number of appeals is rising. Appellants are in particular making ever more frequent use of procedural law as the main object of their appeals by repeatedly filing procedural requests and by requesting recusations, deadline extensions and interim rulings to which they then object.

The Federal Administrative Court passed a key ruling[75] relating to supplementary health insurance. In six cases, policy holders had appealed against FINMA's approval of tariffs. The Federal Administrative Court rejected one of the appeals and invited the other appellants to waive proceedings, stating by way of explanation that the premium increases against which they were appealing did not constitute abuse. FINMA, it said, had been within its rights not to verify the appropriateness of a tariff increase, and the Price Monitoring Act was not applicable either directly or by analogy as long as it could be assumed that the amount of the insurance premiums represents the result of effective competition. Comprehensive inspection of documents was demanded in all of these cases as it would otherwise be impossible to cite sufficient grounds for the appeal. The Federal Administrative Court ruled that the right to inspect documents could be waived when substantial private interests necessitate secrecy. The insurer's interest in guaranteeing business confidentiality, it said, was to be regarded as much more important here than the appellants' interest in being granted full inspection of documents.

[74] See section on 'Insolvency regulations for the financial market', p. 27.
[75] See Federal Administrative Court ruling B-7407/2009 of 7 July 2011.

FINMA AS AN AUTHORITY

BOARD OF DIRECTORS AND EXECUTIVE BOARD

The Board of Directors

The Board of Directors is FINMA's strategic management body. It directs, supervises and controls FINMA's executive management. It decides on matters of substantial importance, issues ordinances and circulars, and is responsible for FINMA's budget. The Board of Directors bears this responsibility as a collective body. Its decisions are taken by a majority of the votes of the members present.

Members of the Board of Directors[76]:

Prof. Anne Héritier Lachat	Chair
Dr Monica Mächler	Vice-Chair
Daniel Zuberbühler	Vice-Chair[77]
Dr Eugenio Brianti	Member
PD Dr Sabine Kilgus	Member[78]
Paul Müller	Member
Charles Pictet	Member
Prof. Jean-Baptiste Zufferey	Member

[76] The term of office of this Board of Directors ended on 31 December 2011. New elections for the entire Board took place on 9 November 2011. The Federal Council confirmed the election of the members standing for office again and appointed three new members to the Board: Yvan Lengwiler, Joseph L. Rickenbacher and Eddy Wymeersch. From January 2012, the FINMA Board of Directors therefore comprises nine members.

[77] Daniel Zuberbühler stepped down as Vice-Chair and member of the Board of Directors at the end of December 2011.

[78] PD Dr Sabine Kilgus stepped down as a member of the Board of Directors at the end of December 2011.

Committees of the Board of Directors

The Board of Directors forms an Audit Committee, an Appointment and Remuneration Committee and a Takeover Committee from among its members. Except where otherwise stipulated, the committees act in an advisory capacity and submit proposals to the Board of Directors. They are headed by a Chair who liaises with the Board of Directors and the Executive Board. In addition to the standing committees, the Board of Directors may form ad hoc committees or commission individual members, notably experts, to prepare business.

The standing committees of the Board of Directors and their members:

	Prof. Anne Héritier Lachat	Dr Monica Mächler	Daniel Zuberbühler	Dr Eugenio Brianti	PD Dr Sabine Kilgus	Paul Müller	Charles Pictet	Prof. Jean-Baptiste Zufferey
Audit Committee		•		•				Chair
Appointment and Remuneration Committee	Chair		•			•		
Takeover Committee	Chair				•		•	•

The Executive Board

The Executive Board is FINMA's operational management body and is responsible for supervising banks, insurance companies, stock exchanges and securities dealers as well as other financial intermediaries in accordance with the law and the respective strategy. It prepares the necessary files and materials for decisions on items of business that fall under the remit of the Board of Directors and is responsible for implementing the resolutions of the Board of Directors and its committees.

Members of the Executive Board:

Dr Patrick Raaflaub	CEO
Mark Branson	Head of Banks Division
Dr René Schnieper	Head of Insurance Division
Yann Wermeille	Head of Markets Division[79]
Dr David Wyss	Head of Enforcement Division[80]
Andreas Zdrenyk	Head of Operations Division[81]
Dr Urs Zulauf	General Counsel and Head of Strategic Services Division

Enforcement Committee

The Enforcement Committee (ENA) is a standing committee of the Executive Board with responsibility for decisions concerning enforcement. Except for matters of substantial importance that are reserved for the Board of Directors, it decides on enforcement rulings as well as the initiation and cessation of important proceedings and criminal complaints, in particular against supervised institutions and individuals.

Permanent members of the Enforcement Committee:

Dr Urs Zulauf	Chair
Dr Patrick Raaflaub	
Dr David Wyss	

Where a supervised institution is the subject of enforcement proceedings, the Executive Board member responsible for its supervision joins the Enforcement Committee for that specific case.

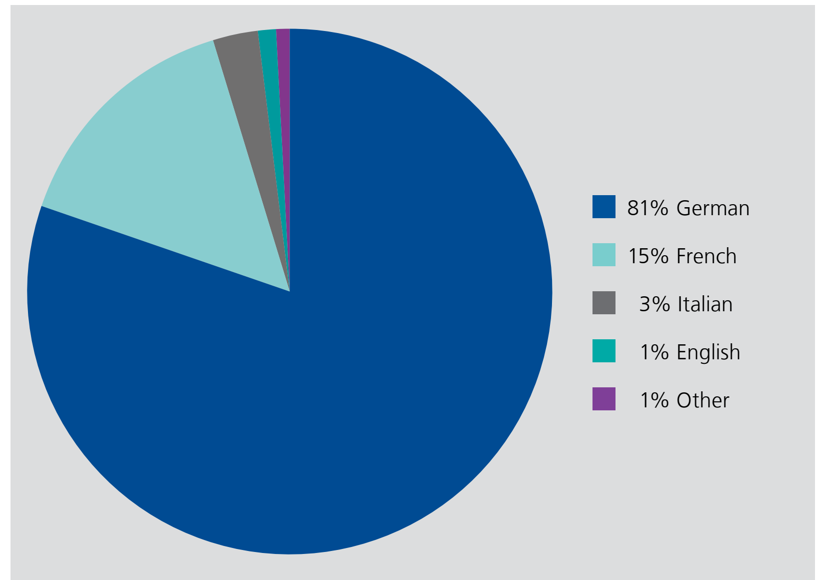
[79] Head of Markets Division since March 2011.
[80] Head of Enforcement Division since March 2011.
[81] Head of Operations Division since August 2011.

STAFF

Headcount and structure

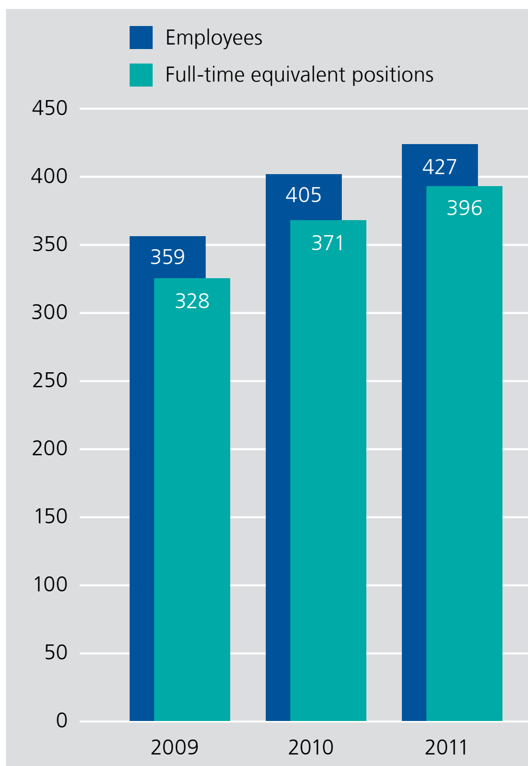
The maximum headcount approved by the Board of Directors for 2011 was 410 full-time equivalent positions. In 2011, FINMA employed an average of 427 employees, across 396 full-time equivalent positions. Approximately 19% of staff work part-time. For 2012, the Board of Directors approved a headcount of 480 full-time equivalent positions. The steady increase in full-time equivalent positions reflects the fact that FINMA has been charged with new supervisory responsibilities following the financial crisis of 2008 and that targeted increases will occur in certain areas that were previously understaffed. The Markets division and the newly created Enforcement division in particular are being expanded accordingly.

Breakdown by language



At the end of 2011, FINMA employed 63 employees of foreign nationality.

Average headcount



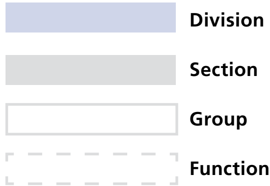
The average age of employees was 40. Approximately 70% of staff are in the 30–49 age range, 18% are aged 50 and over, while 12% are young talents.

Senior management positions are held by 157 employees (35%). Within FINMA, the term 'senior management' covers all line management functions and specialist functions in salary bands 1 to 3. Of senior management, 41% have a line management function, of which 17% are women. Women accounted for 39% of the organisation as a whole in 2011.

Staff turnover (excluding retirement) stood at 16%. By filling the ensuing vacant positions, FINMA seeks to achieve a good mixture. Both experienced staff who have been involved in supervision for many years and the knowledge and experience of newly recruited personnel, chiefly from the supervised sectors, are needed.

ORGANISATION CHART

(status as of 31 December 2011)



* Member of Executive Board

Board of Directors
Anne Héritier Lachat
Chair

CEO
Patrick Raaflaub*

Banks
Mark Branson*

Supervision of UBS
Ursula La Roche

Supervision of CS Group
Michael Loretan

Supervision of Wealth Management Banks and Securities Dealers
François Tinguely

Supervision of Retail, Commercial and Trading Banks
Thomas Hirschi

Risk Management
Roland Goetschmann a.i.

Solvency and Capital
Reto Schiltknecht

Authorisation
Hansueli Geiger

Insurance
René Schnieper*

Supervision of Life Insurance
Eckhard Mihr

Supervision of Non-Life Insurance
Hans-Peter Gschwind

Supervision of Health Insurance
Markus Geissbühler

Supervision of Reinsurance
Stefan Senn

Quantitative Risk Management
Hansjörg Furrer

Qualitative Risk Management
Urs Karlen

Supervision of Insurance Groups
Alain Kupferschmid

Insurance Supervisory Law
Hans-Peter Gschwind

Markets
Yann Wermeille*

Collective Investment Schemes and Distribution
Caroline Clemetson

Asset Management
Murielle de Sepibus

Money Laundering and Market Analysis
Léonard Bôle

Accounting, Audit Firms and Rating Agencies
Kurt Bucher

Supervision of Asset Management and Collective Investment Schemes
Jan Sohnrey

Supervision of Exchanges
Yann Wermeille a.i.

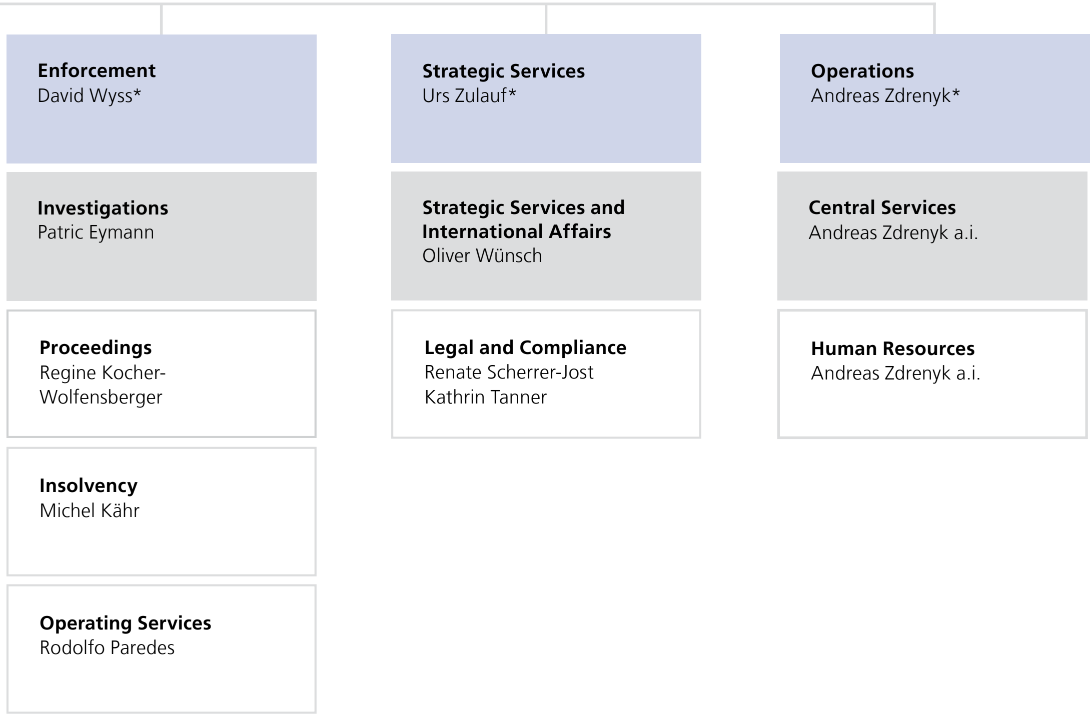


Chart showing the sections and groups managed by the division heads

Human resources strategy

FINMA's human resources management (HRM) was newly established in the first two years of the authority's existence. The main focus was to introduce processes such as salary accounting and recruitment as well as a professional procedure for objective setting and performance assessment of employees. Issues of HRM strategy assumed increasing importance during 2011. Personnel and management development was designed to allow supervisors to offer more effective support to staff. FINMA aims to enhance employee retention and make itself a more attractive employer by developing additional incentives, not necessarily of a financial nature.

Accordingly, in April 2011 FINMA introduced a career and development model that places a career as a specialist on an equal footing with the classic career as a line manager. With this model, FINMA wants to offer its employees a career alternative similar to a line management career. To ensure this equivalence, care was taken to ensure that the same conditions and expectations apply to both the specialist and management functions in a given area. Promotion within the specialist career path is tied to strict specialist criteria and requires a substantial increase in specialist expertise.

In August 2011, FINMA launched a new online portal for job applications, thus creating a modern and user-friendly tool for those interested in working at FINMA. The application process can now be conducted and tracked efficiently using electronic technology. Applicants, FINMA line managers and HR management have an overview of ongoing application processes at all times.

Human resources and salary policy

The salary system at FINMA is based on six overlapping salary bands.

Salary band	Minimum	Maximum
1	215,000	300,000
2	170,000	260,000
3	130,000	210,000
4	100,000	160,000
5	70,000	120,000
6	50,000	90,000

Basic salaries in excess of CHF 300,000 require the approval of the head of the FDF. The maximum figures for the basic salary and variable salary component of the CEO are set at the time of appointment and are subject to approval by the Federal Council. The remuneration of the Board of Directors and Executive Board is presented in the financial statements.

Unlike the central federal administration, FINMA did not grant its employees an inflation-linked pay rise in 2011, since on a cumulative basis the national index of consumer prices applicable to FINMA did not increase by more than 1%.

As of April 2011, 37% of employees received individual salary increases amounting to 1.8% of total salaries. There were substantial differences between the salary increases granted to individual employees. The highest was 21.1%, the lowest 0.8%. Salaries were adjusted where this was appropriate due to employees taking on additional tasks or extra responsibility, or to developments in the labour market. Salary adjustments are not linked to the annual performance assessment. Basic salaries are not automatically adjusted on an annual basis.

Exceptional performance can be rewarded by a variable salary component (bonus).[82] FINMA made use of this option and awarded bonuses to 124 staff members (36%) in 2011. These amounted to 7.5% or 15% of the basic salary or, for members of the Executive Board and senior managers in salary band 2 (16 individuals), 10%, 15% or 20% of the basic salary. In accordance with the FINMA Personnel Ordinance, bonuses were only awarded to staff who had surpassed their agreed objectives.

[82] Art. 22 FINMA Personnel Ordinance.

Operational development within FINMA

Since its foundation, FINMA has been expected to demonstrate that integration does not simply consist of merging existing units, but also creates tangible added value. The relevant processes and instruments are constantly being developed and refined.

As part of a coordinated programme, a number of specific change projects concerned with internal operational development were set in train during 2011. Many of these projects are to be implemented in 2012. All the divisions drew up service mandates and documented their processes. The services offered and requested were negotiated between clients and providers, and their management and measurement were clearly defined. Then each division drew up an operational concept setting out in detail how the services are to be provided. The operational concept also describes the necessary organisational structure and the roles of employees, and contains an operational plan that details the business processes and the management information available.

The drafting of service mandates and operational concepts during 2011 was designed to encourage and require participants to think in terms of standardised business processes. This uniform approach to processes enabled points of commonality between the various specialist areas of FINMA to be located, thereby satisfying one of the key requirements: steady improvements in efficiency and effectiveness within the organisation.

The Enforcement division[83] is acting as a pilot and pioneer in these activities. Specific process improvements and the corresponding use of system instruments based on uniform methods were initiated during 2011. Case management in Enforcement will in future be system-supported, thereby securing permanent access to electronic files.

Technologies

FINMA uses a range of systems and tools to support its business processes and business process structure. One key area of activity during 2011 was the replacement of the decentralised IT systems inherited from its predecessor organisations with integrated, process-oriented technologies. The architecture of the IT infrastructure systems was completely rebuilt. FINMA supplemented standard applications and tools with additional, tailor-made systems. In future, centralised databases will be managed in an integrated manner, enabling electronic files to be stored and managed more precisely and management information to be accessed in a more targeted fashion.

The biggest development and change project within FINMA's operations relates to secure and efficient data exchange with supervised banks and insurance companies and institutions applying for licences. The existing interfaces, such as the FINMA Insurance Reporting and Supervising Tool (FIRST),

[83] See box, p. 75.

are being brought up to date. In future, it should be possible to interact electronically with FINMA quickly and efficiently via a single portal.

A very important aspect of this is data security and data protection extending far beyond the legal basis and regulations. Here, FINMA employs technologies, tools and processes that are certified and represent the state of the art.

Internal operational development: the example of the Enforcement division

In 2011, the Enforcement division laid the foundation stone for the planned further projects on internal operational development throughout FINMA. Previously, a number of bodies were responsible for the tasks that make up Enforcement's remit. The merger has brought with it the expectation that focus areas will be defined more easily and resources targeted to where they are most needed. With litigation becoming more and more time-consuming and labour-intensive, it is vital to exploit synergies in this area. For this reason too, Enforcement has transformed its organisation from one that was geared to supervisory issues to one that is process-oriented.

The Investigations team deals with all incoming indications of breaches of supervisory law and establishes whether proceedings need to be launched or criminal complaints filed. It also exercises supervisory functions, investigating indications of market abuse and uncertainties regarding whether an institution or activity is subject to supervision.

If enforcement proceedings are initiated, the Proceedings team takes over the case. A proceedings manager is responsible for project management and 'unité de doctrine'. Working together with a litigator and further specialists as required, the manager is responsible for the entirety of the legal proceedings and any appeals.

The Insolvency group is responsible for proceedings concerning protective measures. It carries out its own insolvency proceedings or assists liquidators appointed by FINMA. It is also responsible for restructuring. Finally, the Operating Services group provides specialist and administrative support, for example maintaining records of evidentiary hearings.

APPENDIX

FINANCIAL MARKET REGULATION: STATUS AND OUTLOOK

(status as of 31 December 2011)

Project	Contact and information
Cross-sector	
Insolvency and restructuring Changes to depositor protection at banks came into force on 1 September 2011, including a revision of the restructuring proceedings for banks. Additionally, FINMA is now the authority responsible for insolvencies at insurance companies and collective investment schemes, as well as banks. This will require the FINMA implementing provisions to be enacted.	FINMA
Accounting The legislation on accounting standards for banks, securities dealers and insurers is to be amended by revising company and accounting law. Implementing provisions from the Federal Council and FINMA will then be required.	FDF/FINMA
Banks	
Systemic risks ('too big to fail') Based on proposals from a commission of experts, the risks to the economy posed by large, systemically important banks are to be reduced through enhanced prudential requirements.	FDF
Basel III The BCBS has revised its framework to take account of experience with Basel II and the lessons of the financial crisis. Implementation of Basel III in Switzerland is to be achieved by a partial revision of the Ordinance on Capital Adequacy and Risk Diversification plus a series of FINMA circulars.	FDF/FINMA
Mortgage business Intense competition in the mortgage segment is sometimes prompting banks to be less strict in applying financial sustainability and loan-to-value rules. Following adjustments to the existing self-regulatory rules on granting and valuing mortgage loans, this trend is to be counteracted with stricter capital adequacy requirements.	FDF
Countercyclical buffer A variable, countercyclical buffer is planned as a further instrument to strengthen banks' equity capital, which is to some extent procyclical.	FDF
Liquidity The financial crisis also revealed a need for regulatory action in connection with the current liquidity regime. Further clarifications are currently under way. The necessary adjustments to the regime are to be implemented via a separate liquidity ordinance.	FDF/FINMA

Regulatory level	Status and next steps				
	Drafting	Hearing/ consultation	Revision/ discussion	Approval	Planned entry into force
ordinance	in progress	Q1/12 (banks) open (insurers, collective investment schemes)	Q2/12 (banks) open (insurers, collective investment schemes)	Q2/12 (banks) open (insurers, collective investment schemes)	open
ordinance/ circular	open	open	open	open	open
law and ordinance	√	√ (law) in progress (ordinance)	√ (law) Q1/12 (ordinance)	√ (law) Q2/12 (ordinance)	Q2/12 (law) Q1/13 (ordinance)
ordinance/ circular	√	in progress	Q1/12	Q2/12	Q1/13
ordinance	√	in progress	Q1/12	Q1/12	Q1/12
ordinance	√	in progress	Q1/12	Q1/12	open
ordinance/ circular	open	open	open	open	open

Project	Contact and information
Banks	
Dormant assets Banks are to be allowed to liquidate dormant assets following prior publication, with the proceeds going to the Confederation. The claims of beneficiaries who do not respond to the publication would lapse.	FDF
Insurers	
Insurance contracts The total revision of insurance contract law aims to bring the legal framework into line with changed requirements and provide reasonable and practicable protection for policy holders. The draft law published in September 2011 aims to achieve a better balance between the obligations of insurers and those of policy holders.	FDF
Insurance supervision Practical application of the totally revised Insurance Supervision Act (in force since 1 January 2006) together with current developments in the market and international trends has revealed a need for change at the regulatory level. Further clarifications are currently under way. The goal is to eliminate contradictions, improve the legislation to better protect the interests of policy holders and achieve international compatibility.	FINMA
Liquidity reporting (insurers) An integrated approach to solvency must take account of both capital and liquidity and the interactions between them. The aim is to produce a circular setting out the principles and minimum requirements regarding the nature, content and structure of standardised, periodic liquidity reporting.	FINMA
Markets	
Collective investment schemes Swiss law is to be brought into line with international standards governing the management, safekeeping and distribution of collective investment schemes. The amendments should enhance investor protection, improve the quality of asset management in Switzerland and secure access to EU markets for Swiss providers.	FDF
Stock exchange offences and market abuse The draft revision of the law on the prosecution of stock exchange offences published in September 2011 aims above all to extend the definition of the crime of insider trading, enhance the duty to disclose holdings and improve its implementation.	FDF

	Regulatory level	Status and next steps				
		Drafting	Hearing/ consultation	Revision/ discussion	Approval	Planned entry into force
	law and ordinance	√ (law) open (ordinance)	√ (law) open (ordinance)	in progress (law) open (ordinance)	open	open
	law	√	√	in progress	open	open
	open	open	open	open	open	open
	circular	open	open	open	open	open
	law and ordinance	√ (law) open (ordinance)	in progress (law) open (ordinance)	open	open	open
	law	√	√	in progress	open	open

STATISTICS

(status as of 31 December 2011)

Supervised institutions[84]

Supervised banks	(2010)	2011
Banks, of which:	(326)	314
– under foreign control	(121)	112
– branches of foreign banks	(36)	34
Raiffeisen banks	(339)	328
Representative offices of foreign banks	(48)	45

Supervised securities dealers		
Securities dealers, of which:	(72)	64
– under foreign control	(19)	18
– branches of foreign securities dealers	(15)	11
Representative offices of foreign securities dealers	(40)	43
Recognised foreign market participants	(139)	142

Supervised stock exchanges		
Swiss stock exchanges	(3)	3
Swiss organisations that are similar to stock exchanges	(2)	2
Recognised foreign stock exchanges	(45)	50
Recognised foreign organisations that are similar to stock exchanges	(4)	6

Supervised collective investment schemes

Swiss collective investment schemes		
Total Swiss collective investment schemes, of which:	(1,400)	1,403
– open-ended collective investment schemes (under Art. 8 CISA)		
– contractual investment funds and SICAVs	(1,387)	1,389
– of which intended for qualified investors only	(627)	643
– closed-ended collective investment schemes (under Art. 9 CISA)		
– limited partnerships for collective investment and SICAVs	(13)	14

Foreign collective investment schemes	(2010)	2011
Total foreign collective investment schemes, of which:	(5,791)	6,058
– EU-compatible (UCITS)	(5,439)	5,754
– non-EU-compatible (non-UCITS)	(352)	304

Supervised asset managers and distributors under CISA		
Asset managers	(83)	90
Distributors	(420)	416

Supervised insurance companies and health insurance schemes		
Life insurance companies, of which:	(25)	24
– insurance companies domiciled in Switzerland	(21)	20
– branches of foreign insurance companies	(4)	4
Non-life insurers, of which:	(126)	124
– insurance companies domiciled in Switzerland (incl. 25 supplementary health insurance providers [2010: 20])	(79)	78
– branches of foreign insurance companies	(47)	46
Reinsurers (total)	(62)	61
– Reinsurers	(27)	27
– Reinsurance captives	(35)	34
Health insurance schemes that offer supplementary health insurance	(35)	16
Total supervised insurance companies and health insurance schemes	(248)	225

Supervised financial intermediaries		
Total supervised SROs	(11)	12
Total DSFIs	(412)	389
Total registered insurance intermediaries	(12,854)	13,191

[84] The term 'supervised' does not necessarily mean that an institution is supervised by FINMA.

Recognised audit firms and credit rating agencies	(2010)	2011
Total recognised audit firms of which:	(115)	107
– only for DSFIs	(99)	92
Total recognised credit rating agencies	(5)	5

Licences

Banks and securities dealers

Banks

Banking licences (Art. 3 BA)	(8)	0
Branches (Art. 4 FBO-FINMA)	(1)	2
Representative offices (Art. 14 FBO-FINMA)	(2)	4
Additional licences (Art. 3ter BA)	(10)	8
Removed from supervision	(2)	7

Securities dealers

Securities dealer licences (Art. 10 SESTA)	(4)	1
Branches (Art. 41 SESTO)	(5)	0
Representative offices (Art. 49 SESTO)	(5)	10
Additional licences (Art. 10 para. 6 SESTA and Art. 56 para. 3 SESTO	(3)	4
Removed from supervision	(2)	2
Recognition of foreign market participants	(17)	11

Exchanges

Recognition of foreign exchanges (including organisations that are similar to stock exchanges)	(4)	7

Collective investment schemes

Swiss collective investment schemes	(189)	103
Foreign collective investment schemes	(1,184)	907

Asset managers and distributors under CISA

Asset managers	(15)	7
Distributors	(14)	12

Insurance companies	(2010)	2011
Life insurance companies, of which:	(0)	0
– insurance companies domiciled in Switzerland	(0)	0
– branches of foreign insurance companies	(0)	0
Non-life insurers, of which:	(5)	2
– insurance companies domiciled in Switzerland	(3)	2[85]
– branches of foreign insurance companies	(2)	0
Reinsurers	(2)	1
Reinsurance captives	(1)	1
Health insurance schemes that offer supplementary health insurance	(1)	0
Total	(9)	4

Financial intermediaries

Insurance intermediaries	(550)	641
DSFIs	(23)	22

Audit firms and credit rating agencies

Total rulings regarding changes of audit firm, of which:	(66)	26
– related to DSFIs	(20)	8
Recognitions of audit firms	(5)	0
Cancellations of audit firms	(8)	7
Recognitions of credit rating agencies	(0)	0

Rulings

ENA rulings	(51)	51
Swiss Takeover Board rulings	–	7

Complaints and requests to initiate criminal proceedings

Complaints submitted	(27)	29
Complaints settled	(24)	42
Complaints filed with criminal prosecution authorities	(32)	76

[85] The order for one of these life insurers supervised since 2011 had not yet entered into force at the time of going to press (pending at the Federal Administrative Court).

MoUs AT NATIONAL AND INTERNATIONAL LEVEL

No MoUs were concluded or amended at the national level in 2011.

MoUs concluded in 2011 (international)			
Bilateral MoUs			
Country	**Foreign authority**	**Form**	**Area of application**
Dubai	DFSA (Dubai Financial Services Authority)	MoU	Banks, markets (since 2007), insurance companies (new)
USA	CID (Connecticut Insurance Department)	MoU	Insurance companies
USA	NYSID (New York State Insurance Department)	MoU	Insurance companies
Multilateral MoUs			
Country	**Authorities**	**Form**	**Area of application**
n/a	IAIS	MMoU	Insurance companies
Denmark, Finland, Sweden	SNB (Swiss National Bank), Finanstilsynet, Danmarks Nationalbank, Finanssivalvonta, Suomen Pankki, Finansinspektionen, Sveriges Riksbank	MoU	Supervision and monitoring of SIX x-clear
Germany	BaFin (Federal Financial Supervisory Authority) DB (Deutsche Bundesbank) SNB (Swiss National Bank)	MoU	Supervision and monitoring of Eurex Clearing AG
France	ACP (Autorité de Contrôle Prudentiel)	MoU	AXA Group Supervisory College
USA	FAOA (Federal Audit Oversight Authority) PCAOB (Public Company Accounting Oversight Board)	MoU	Audit firms

FINMA'S REPRESENTATION IN INTERNATIONAL WORKING GROUPS

International organisations and committees[86]

Financial Stability Board (FSB)
- Standing Committee on Supervision and Regulatory Cooperation
- Resolution Steering Group

Basel Committee on Banking Supervision (BCBS)
- Governors and Heads of Supervision
- International Conference of Banking Supervisors
- Basel Committee on Banking Supervision

International Association of Insurance Supervisors (IAIS)
- Executive Committee
- Financial Stability Committee
- Technical Committee (chair)

International Organization of Securities Commissions (IOSCO)
- Technical Committee
- Presidents' Committee

Financial Action Task Force (FATF)
- Plenum
- Expert Group A / Expert Group B

Organisation for Economic Co-operation and Development (OECD)
- Insurance and Private Pensions Committee
- IPPC Task Force on Insurance Statistics

Other international forums

- Integrated Financial Supervisors Conference
- Wilton Park Securities Supervision Conference / International Cooperation and Enforcement
- Meeting of four German-speaking nations (banking and insurance)
- Conférence Francophone (insurance)
- Institut Francophone de la Régulation Financière (IFREFI)
- Swiss Futures and Options Association Regulators' Meeting (Bürgenstock Meeting)

[86] This list is confined to committees of which representatives of the Board of Directors and/or Executive Board of FINMA are members. In addition, many members of FINMA staff are involved in working groups.

GLOSSARY[87]

Basel framework	The Basel framework is a multilateral agreement on capital adequacy rules for banks. The first such agreement, Basel I, was passed by the Basel Committee on Banking Supervision in 1988. It was substantially enhanced by Basel II adopted in 2004. The new framework, derived from the experience of the current financial market crisis, was developed in 2010 and is known as Basel III. See 'Basel III'.
Basel III	At the end of 2010, the Basel Committee adopted stricter, across-the-board global rules on equity capital and liquidity designed to strengthen the resistance of the banking sector. The key changes are: – improvements to the quality, consistency and transparency of the capital base; – higher capital adequacy requirements for the default risk of derivatives, repurchase agreements and securities financing transactions; – a new capital requirement for the risk of market value losses on OTC derivatives; – supplementing the risk-based capital requirement with an unweighted leverage ratio; – measures to reduce procyclicality and promote countercyclical buffers; – measures to combat systemic risk, with particular emphasis on systemically important banks, and – the introduction of global liquidity standards.
Common Equity Tier 1 capital (CET1)	Common equity refers to Common Equity Tier 1, i.e. loss-absorbing equity capital of the highest quality. CET1 consists of paid-in capital, disclosed reserves and retained earnings. See 'Risk-weighted assets' (RWA).
Contingent convertible capital (CoCo bonds or CoCos)	Contingent convertible capital is debt capital that can be converted into equity under certain conditions. It is designed to improve a bank's situation in a crisis or enable its resolution by allowing it to store up additional capital during periods of economic growth that can be accessed as equity in a downturn. Conversion is mandatory once a predetermined trigger point is reached.
Convertible capital	See 'Contingent convertible capital' (CoCo bonds or CoCos).

[87] This glossary is intended to facilitate reading by explaining important terms. It is neither an exhaustive list nor does it have any legal bearing.

Countercyclical capital buffer	The countercyclical capital buffer aims to strengthen the banking sector's resistance to risks during periods of excessive credit growth by obliging banks to hold additional equity capital during times of strong credit growth. This enhances their capacity to absorb any credit defaults in a cyclical downturn and also makes loans more expensive for customers, thereby curbing demand. In a downturn, the countercyclical capital buffer is reduced or eliminated, and the assets freed up can then be used once again for lending. The countercyclical capital buffer is part of the Basel III framework.
E-money	E-money is a relatively new form of money additional to the money issued by central banks and the book money of commercial banks. It is a monetary asset in the form of a claim against the issuing body that: – is stored on a data storage medium; – is issued against a sum of money of no less value that the monetary asset issued; and – is accepted as a means of payment by companies other than the issuing body. E-money should not be confused with electronic access processes involving bank deposits such as debit or credit card payments.
Front running (also known as forward trading)	Front running involves exploiting confidential information about upcoming client transactions to one's own advantage in ways that may constitute misuse of information or a breach of the duty of loyalty.
Leverage ratio	Ratio of equity capital to debt capital (or, often, vice versa). As a regulatory provision, the leverage ratio also refers to the minimum requirement for equity capital in relation to a Swiss big bank's overall exposure. A leverage ratio is not a risk-weighted indicator.
Multilateral trading facility (MTF)	A multilateral trading facility is a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments. See Art. 4 para. 1 no. 15 MiFID.
Net asset value	The net asset value of a collective investment scheme consists of the market value of the assets less any liabilities (Art. 83 para. 2 CISA).
Non-UCITS	Non-UCITS are collective investment schemes that are not subject to the EU's UCITS Directive. The UCITS Directive sets out Europe-wide standard requirements for collective investment schemes open to the public. See also 'Undertakings for Collective Investment in Transferable Securities' (UCITS).

OTC swap	A swap is an agreement to exchange payments on a specified date in the future or upon the occurrence of an event. The amount of the individual payment is either fixed by agreement or derived from the value of one or more underlying assets at a given time (Art. 25 para. 4 let. o CISO-FINMA). A swap is 'over the counter' (OTC) when it is concluded outside a stock exchange or other regulated market open to the public (Art. 25 para. 4 let. m CISO-FINMA).
Prudential supervision	Prudential supervision aims first and foremost to ensure that solvency is guaranteed, adequate risk control is in place and that proper business conduct is assured. Prudential supervision thus also contributes indirectly to the financial markets' ability to function and to the competitiveness of Switzerland's financial sector. Comprehensive supervision of banks, insurance companies and other financial intermediaries is based on the licensing requirement for a specific type of activity, ongoing monitoring of compliance with the licence conditions and other factors that are subject to regulation.
Recovery, resolution and resolvability	– Recovery occurs when a company succeeds in stabilising itself – i.e. restructuring – of its own accord. – Resolution is the forced restructuring of a company by the authorities. – Resolvability means the ability of a company to be dissolved or wound up.
Risk-weighted assets (RWA)	Assets or positions weighted to take account of the risk they involve. The risk weighting is based on the assumption that not every loan entails the same level of risk. For this reason, less risky positions require less equity to underpin them than more risky ones. Since the introduction of Basel II, RWA are the central basis for measuring capital ratios such as CET1. See 'Basel framework' and 'Common Equity Tier 1 capital' (CET1).
Scalping	Scalping involves exploiting the expected reaction of market participants and securities prices to an upcoming publication of investment recommendations of which one is already aware.
Solvency II	Solvency II primarily refers to the EU framework directive 2009/138/EC of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II). It is often also used to refer to the economic and risk-based method of assessing the capital adequacy of an insurance company contained in the framework directive. In quantitative terms, Europe's Solvency II pursues aims comparable to those of Switzerland's SST.

Term	Definition
SST ratio	The SST ratio is calculated by dividing risk-bearing capital by target capital. It shows what percentage of the risk capital required as a result of the individual risk profile is covered by equity capital.
Swiss Solvency Test (SST)	The SST is a supervisory instrument that uses economic and risk-based principles to measure the solvency of insurers. It was introduced in 2006 when the Insurance Supervision Act was completely revised. It assesses the financial situation of an insurance company on the basis of the ratio of eligible equity (risk-bearing capital) to regulatory capital (target capital). These are determined taking into account the risks incurred.
Systemic importance	Systemic risks are risks emanating from individual market participants that jeopardise the stability of the entire economy ('system'). Companies that carry out functions which are indispensable to the economic system, or which cannot be replaced by other companies, are termed 'systemically important'. One example of a systemically important function is the processing of payment transactions by banks.
'Too big to fail'	A company is categorised as 'too big to fail' if its collapse would endanger the stability of the entire economy, thereby compelling the state to rescue it. Discussion of the 'too big to fail' issue focuses on the systemic risks emanating from such companies.
Trigger	See 'Contingent convertible capital' (CoCo bonds or CoCos).
Undertakings for Collective Investment in Transferable Securities (UCITS)	The UCITS Directive sets out Europe-wide standard requirements for collective investment schemes open to the public.
Variable annuity	A life insurance product that offers investment security by combining the advantages of traditional life products with those of unit-linked products. It is a form of fund-linked retirement insurance purchased by either a one-off payment or ongoing contribution payments that offers a guaranteed minimum benefit.

ABBREVIATIONS[88]

AIFMD	(EU) Alternative Investment Fund Managers Directive
BA	Swiss Federal Act of 8 November 1934 on Banks and Savings Banks (Banking Act; SR 952.0)
BCBS	Basel Committee on Banking Supervision
CAO	Swiss Federal Ordinance of 29 September 2006 on Capital Adequacy and Risk Diversification for Banks and Securities Dealers (Capital Adequacy Ordinance; SR 952.03)
CC	Control Committees of the Swiss Federal Assembly
CEAT	Committees for Economic Affairs and Taxation
CISA	Swiss Federal Act of 23 June 2006 on Collective Investment Schemes (Collective Investment Schemes Act; SR 951.31)
CISO	Swiss Federal Ordinance of 22 November 2006 on Collective Investment Schemes (Collective Investment Schemes Ordinance; SR 951.311)
ComFrame	Common Framework for the Supervision of Internationally Active Insurance Groups
DSFI	Directly subordinated financial intermediary
EBA	European Banking Authority
EIOPA	European Insurance and Occupational Pensions Authority
ENA	Enforcement Committee
FAOA	Swiss Federal Audit Oversight Authority
FATCA	(US) Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FBO-FINMA	Ordinance of 21 October 1996 of the Swiss Financial Market Supervisory Authority on Foreign Banks in Switzerland (FINMA Foreign Banks Ordinance; SR 952.111)
FDF	Swiss Federal Department of Finance
FINMA	Swiss Financial Market Supervisory Authority
FINMASA	Swiss Federal Act of 22 June 2007 on the Swiss Financial Market Supervisory Authority (Financial Market Supervision Act; SR 956.1)
FIRST	FINMA Insurance Reporting and Supervising Tool
FSA	(UK) Financial Services Authority
FSB	Financial Stability Board
FSC	Financial Stability Committee
GIIPS	Greece, Italy, Ireland, Portugal and Spain
G-SIB	Global systemically important bank
G-SII	Global systemically important insurer
IAIG	Internationally active insurance group
IAIS	International Association of Insurance Supervisors
ICA	Swiss Federal Act of 2 April 1908 on Insurance Contracts (Insurance Contract Act; SR 221.229.1)
ICP	Insurance Core Principles
IOSCO	International Organization of Securities Commissions
ISA	Swiss Federal Act of 17 December 2004 on the Supervision of Insurance Companies (Insurance Supervision Act; SR 961.01)
ISO	Swiss Federal Ordinance of 9 November 2005 on the Supervision of Private Insurance Companies (Insurance Supervision Ordinance; SR 961.011)
KIID	Key Investor Information Document
MiFID	Markets in Financial Instruments Directive
MMoU	Multilateral Memorandum of Understanding
MoU	Memorandum of Understanding
OPA	Swiss Federal Act of 25 June 1982 on Occupational Old Age, Survivors' and Invalidity Pension Provision (Occupational Pensions Act; SR 831.40)
PCAOB	(US) Public Company Accounting Oversight Board
PEP	Politically exposed person
SBA	Swiss Bankers Association
SESTA	Swiss Federal Act of 24 March 1995 on Stock Exchanges and Securities Trading (Stock Exchange Act; SR 954.1)
SESTO	Swiss Federal Ordinance of 2 December 1996 on Stock Exchanges and Securities Trading (Stock Exchange Ordinance; SR 954.11)
SFBC	Swiss Federal Banking Commission (one of FINMA's predecessor authorities)
SICAF	Investment company with fixed capital
SICAV	Investment company with variable capital
SIF	Swiss State Secretariat for International Financial Matters
SNB	Swiss National Bank
SQA	Swiss Qualitative Assessment
SRO	Self-regulatory organisation
TIS	Team Intensive Supervision

[88] The terms explained in the Glossary and the associated abbreviations are not included in this list.

FINMA's CORE VALUES

Systematic supervisory activity

FINMA acts as a supervisory authority, protecting financial market customers and the operation of the Swiss financial sector. It performs its supervisory tasks using the instruments of licensing, monitoring, regulation and enforcement. In so doing, it pursues a risk-based approach that ensures continuity and predictability. FINMA fosters dialogue with supervised institutions, authorities, professional associations and other key institutions both nationally and internationally.

Independent decision-making

FINMA is functionally, institutionally and financially independent, and performs a sovereign function in the public interest. It operates in an environment characterised by the diverging interests of various stakeholders. It preserves its autonomy and acts on the basis of its statutory remit, reaching its decisions independently and in a manner appropriate to the circumstances.

Responsible staff

FINMA's staff combine responsibility, integrity and the ability to deliver results. They are independent, highly flexible and adaptable. FINMA's staff are skilled and able to cope with resistance and challenging situations. They take account of changes in their operating environment and respond with concrete measures that are both timely and appropriate.

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